

## New models of corporate criminality and the problem of corporate fraud: prevention or cure?

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*Concerns over corporate behaviour in areas as seemingly disparate as homicide, manslaughter, bribery and tax evasion have led to experimentation with new models of corporate criminality, as distinct from individual criminality, to avoid obstacles to prosecution posed by the common law's identification principle that effectively limits prosecution to small companies where an individual can be said to be the company's "directing mind and will". Foremost amongst these has been the "failure to prevent" model introduced by the Bribery Act 2010. This has been perceived to have been successful in changing corporate behaviour, with widespread adoption of new corporate practices evidencing that compliance is taken seriously. As a consequence, it has been proposed that this model be extended to other areas of behaviour regarded as economic crimes. HMRC warmly endorsed the model and the Criminal Finances Act 2017, which received Royal Assent on 27 April 2017, contains new corporate tax offences, relating to the failure to prevent UK and foreign tax evasion that are expected to come into force by the end of September 2017. In early 2017, the Ministry of Justice issued a "Call for Evidence on Corporate Liability for Economic Crime", with particular reference to its proposal to create "failure to prevent" fraud, false accounting and money-laundering offences. This article focuses specifically on the potential of the new model to combat corporate fraud and evaluates: the problem of "economic crime"; the historical development of the "failure to prevent" model of organisational liability for bribery; its effectiveness in the context of the Bribery Act 2010; the relative ineffectiveness of the law in combatting fraud in a financial services context; and the appropriateness of the "failure to prevent" model to "economic crime", specifically fraud. In conclusion, it argues for the retention of the common law as a flexible and effective tool in appropriate cases. We argue that the "failure to prevent" model will be a useful extension of the law when combined with a due diligence defence as it may improve corporate behaviour in a range of typically larger companies where the common law is unlikely to assist. However, we argue that it is nonetheless severely limited in its application to criminal frauds because it is predicated on the commission of an offence by an individual. In such cases where the individuals involved in the conduct are not as individuals dishonest, it is argued that an additional mechanism is required to enforce the core criminal offences committed and reflect and stigmatise corporate culpability appropriately. The authors recommend this be done by way of a simple Criminal Practice Direction in relation to offending of this nature restating orthodox and well-established evidential presumptions in the criminal law.*

### THE PROBLEM OF "ECONOMIC CRIME"

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## Growth in international and national scale

Criminal activity involving companies, whether in terms of money-laundering, fraud, bribery or tax evasion seems increasingly unresponsive to traditional legal strategies and has grown to a scale incurring significant economic consequences. In the aftermath of the global financial crisis, evidence of misconduct is emerging that has never before “occurred so systematically, in such a scale and across multiple jurisdictions.”<sup>2</sup>

The estimates globally for money-laundering are truly eye-watering. According to a study of studies conducted by the UN Office on Drugs and Crime the amounts *available* for money-laundering in 2009 were equivalent to 3.6% of GDP or US\$ 2.1 trillion<sup>3</sup> with *money flows* relating to transnational organised crime activities equivalent to 1.5% of global GDP or US\$ 870 billion.<sup>4</sup> Furthermore, 70% of these money flows would have been *available* for laundering through the financial system, equivalent to 1% of global GDP or US\$ 590 billion.<sup>5</sup> The UK’s National Crime Agency believes that “many hundreds of billions of international criminal money is laundered through UK banks, including their subsidiaries, each year”.<sup>6</sup> HM Treasury and the Home Office see money-laundering as a key enabler of serious and organised crime, involving more broadly based measures of social and economic costs, estimated at £24 billion each year as well as a threat to national security.<sup>7</sup> Reflecting perhaps the increasing priority attached to this issue, the Financial Conduct Authority (FCA) announced its largest penalty ever for a failure to maintain an adequate anti-money-laundering control framework against Deutsche Bank AG, being a fine of just over £163 million in January 2017.<sup>8</sup>

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<sup>2</sup> M. Shafik, Bank of England Deputy Governor, Markets and Banking, “From ‘ethical drift’ to ‘ethical lift’: Reversing the tide of misconduct in global financial markets” speech given at the panel discussion Federal Reserve Bank of New York Conference on ‘Reforming Culture and Behaviour in the Financial Services Industry’ Oct. 20, 2016, at [www.bankofengland.co.uk/publications/Pages/speeches/default.aspx/Documents/speeches/2016/speech930.pdf](http://www.bankofengland.co.uk/publications/Pages/speeches/default.aspx/Documents/speeches/2016/speech930.pdf) [Accessed May 29, 2017]. See also the comments made by the European Parliament, Directorate General for Internal Policies, Policy Dept A: Economic and Scientific Policy, Consumer Protection Aspects of Financial Services (2014), IP/A/IMCO/ST/2013-07 Feb. 2014 at [http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/507463/IPOL-IMCO\\_ET\(2014\)507463\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/507463/IPOL-IMCO_ET(2014)507463_EN.pdf) [Accessed May 29, 2017].

<sup>3</sup> “Estimating illicit financial flows resulting from drug trafficking and other transnational organised crime: Research Report” (UNODC, October 2011), at [http://www.unodc.org/documents/data-and-analysis/Studies/Illicit\\_financial\\_flows\\_2011\\_web.pdf](http://www.unodc.org/documents/data-and-analysis/Studies/Illicit_financial_flows_2011_web.pdf) [Accessed May 21, 2017].

<sup>4</sup> “Estimating illicit financial flows resulting from drug trafficking and other transnational organised crime: Research Report” (UNODC, October 2011), at [http://www.unodc.org/documents/data-and-analysis/Studies/Illicit\\_financial\\_flows\\_2011\\_web.pdf](http://www.unodc.org/documents/data-and-analysis/Studies/Illicit_financial_flows_2011_web.pdf) [Accessed May 21, 2017] pp.5-7.

<sup>5</sup> “Estimating illicit financial flows resulting from drug trafficking and other transnational organised crime: Research Report” (UNODC, October 2011), at [http://www.unodc.org/documents/data-and-analysis/Studies/Illicit\\_financial\\_flows\\_2011\\_web.pdf](http://www.unodc.org/documents/data-and-analysis/Studies/Illicit_financial_flows_2011_web.pdf) [Accessed May 21, 2017] pp.5-7.

<sup>6</sup> <http://www.nationalcrimeagency.gov.uk/crime-threats/money-laundering> [Accessed May 5, 2017].

<sup>7</sup> HM Treasury & Home Office, “UK national risk assessment of money-laundering and terrorist financing” (Oct. 2015), p.3. This figure is dominated by the cost of drug-supply of £10.7 billion and fraud with a cost of £8.9 billion, see p.19. The report acknowledges that less is known of the costs of cyber-crime and modern slavery.

<sup>8</sup> Financial Conduct Authority Final Notice to Deutsche Bank AG dated 30<sup>th</sup> Jan. 2017, at <https://www.fca.org.uk/publication/final-notices/deutsche-bank-2017.pdf> [Accessed May 21, 2017].

The estimates for the amount of bribery and its costs, which may be very different, have become the subject of some controversy.<sup>9</sup> Estimates indicate that the scale of the problem internationally has grown from \$1.1 trillion in 2005 to between \$1.5 trillion to \$2 trillion in 2015.<sup>10</sup> The proportion of companies that have to pay bribes to win or retain business varies enormously globally, 15% in industrialised countries, 30% in Asia and 60% in former Soviet Union countries.<sup>11</sup> The position in the UK is unclear; however, some idea of the potential scale of the problem may be shown by the record payment of £497.25 million plus interest and costs by Rolls-Royce plc under the terms of a Deferred Prosecution Agreement made with the Serious Fraud Office (SFO) in 2017, following a four-year investigation into bribery and corruption, with the total paid out by Rolls-Royce being approximately £671 million when payments to the US and Brazil were taken into account.<sup>12</sup> The costs of bribery are often indirect or concealed; as the Ministry of Justice has pointed out they may include: contracts not being specified or enforced properly, e.g. services not performed to the required standard or over-specified with unnecessary gold-plating; transaction costs may be higher; competition impaired; incentives to invest and innovate undermined; as well as serious reputational damage and strategic disruption if concerns arise.<sup>13</sup> However, in the case of bribery, it has been argued that the new approach to imposing criminal liability in the Bribery Act 2010 has had a significant impact in addressing and perhaps reducing bribery in the UK.

Equally eye-watering are the global estimates for fraud. PKF have estimated that in 2013 the global loss from fraud might have cost an equivalent of £2.78 trillion, more than 50% greater than the UK's entire GDP for the period.<sup>14</sup> Examples of the sorts of areas where losses were found to have been measured were wide-ranging, whether in terms of sector, e.g. agriculture, construction, education and housing and in terms of activity e.g. compensation, payroll and procurement.<sup>15</sup> Using the terminology employed in the National Fraud Indicator, fraud alone is estimated to have cost<sup>16</sup> the UK economy a staggering £193 billion in 2016,<sup>17</sup> rising from £52 billion in 2013.<sup>18</sup> While the exponential leap in the amount estimated over that period may be explained more by other factors than by a particularly sharp increase in fraudulent

<sup>9</sup> See, for example, M. Stephenson "The Amount of Bribery and the Cost of Bribery are not the same", The Global Anticorruption Blog (15.12.15).

<sup>10</sup> International Monetary Fund, Staff Discussion Note "Corruption: Costs and Mitigating Strategies" (May 2016), p.5, citing D. Kaufman "Myths and Realities of Governance and Corruption" (Munich: MPRA Paper 8089) (2005) and an extrapolation by him in 2015 based on the earlier estimate.

<sup>11</sup> Transparency International UK, Corruption Data at <http://www.transparency.org.uk/corruption-data>, cited by Ministry of Justice "Impact Assessment of bill on reform of the law on bribery" (Implementation stage, version 2), p.7.

<sup>12</sup> "SFO completes £497.25 million Deferred Prosecution Agreement with Rolls-Royce PLC", SFO News Release 17 Jan. 2017.

<sup>13</sup> Ministry of Justice, "Impact Assessment of bill on reform of the law on bribery", (Implementation stage, version 2), p.7.

<sup>14</sup> J. Gee and M. Button, "The Financial Cost of Fraud 2015" (PKF and University of Portsmouth, 2015), p.10.

<sup>15</sup> J. Gee and M. Button, "The Financial Cost of Fraud 2015" (PKF and University of Portsmouth, 2015), p.7.

<sup>16</sup> This may be better expressed as a misallocation of resources.

<sup>17</sup> PKF, Experian and Portsmouth University Centre for Counter Fraud Studies, "Annual Fraud Indicator 2016" at <http://www.port.ac.uk/media/contacts-and-departments/icjs/ccfs/Annual-Fraud-Indicator-2016.pdf> [Accessed May 21, 2016].

<sup>18</sup> National Fraud Authority, 6 June 2013 at <http://www.gov.uk/government/publications/annual-fraud-indicator--2> [Accessed May 21, 2017].

activity itself,<sup>19</sup> it is quite clear that fraud remains a widespread problem despite considerable legislative attention in the Fraud Act 2006. Beyond the quantifiable financial cost, there is also the documented social cost of economic crime: small businesses forced into bankruptcy, livelihoods ruined, jobs destroyed and opportunities lost, the inestimable impact on society and people's health and well-being.<sup>20</sup>

It may even be that the global estimates for fraudulent behaviour cited above grossly underestimate the full extent of fraudulent behaviour, acknowledging as they do frauds perpetrated against organisations but not necessarily those arguably committed by them. This is not a matter of criticism but simply reflects the different methodologies that may be employed in the selection and calculation of activities considered criminally fraudulent. The authors have addressed this issue elsewhere in terms of how addressing off-balance sheet finance as a matter of accounting regulation means that its potential categorisation as criminal fraud may be overlooked<sup>21</sup>. The impact of addressing other forms of misconduct as matters of financial services regulation may have similar effect. Accordingly, the 2016 Annual Fraud Indicator provides a comprehensive account of a number of types of fraud but does not refer to the various mis-selling cases that have pervaded the financial services industry.<sup>22</sup> If put to the test in the criminal courts, many of the numerous mis-selling scandals that have hit the headlines over recent years, might perhaps be found to constitute fraud.<sup>23</sup> On this basis, £54 billion might be added to the figures, representing the total in compensation paid out by the major retail banks and building societies in the UK in the 15 years since 2000 for mis-selling activities.<sup>24</sup> In addition, further claims, currently estimated to amount to £33 billion, may result from the Supreme Court decision in *Plevin v Paragon [2014]* relating to the non-

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<sup>19</sup> For example, different methodologies for the reports and, in particular, the fact that there is no accepted definition of "fraud" which leaves the scope of the activities included in the reports open to variation.

<sup>20</sup> New City Agenda and Cass Business School, "Cultural Change in the FCA, PRA and Bank of England, Practising What They Preach?", 25 October 2016 at [http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report\\_embargoed.pdf](http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report_embargoed.pdf) [Accessed May 21, 2017] p.13.

<sup>21</sup> S. Copp and A. Cronin, "The failure of criminal law to control the use of off balance sheet finance during the banking crisis" (2015) 36 *Company Lawyer* (4) 99.

<sup>22</sup> PKF, Experian and Portsmouth University Centre for Counter Fraud Studies, "Annual Fraud Indicator 2016" at <http://www.port.ac.uk/media/contacts-and-departments/icjs/ccfs/Annual-Fraud-Indicator-2016.pdf> [Accessed May 21, 2016] which specifically includes tax fraud, NHS fraud, benefits fraud, vehicle excise fraud, TV licence fee fraud, blue badge fraud, retail and telecommunications fraud, council tax fraud, rail transport fraud, ID fraud against consumers, payroll fraud, procurement fraud, grants fraud, mortgage fraud, credit/debit card fraud, cheque fraud, housing tenancy fraud, motor finance fraud, insurance fraud.

<sup>23</sup> The generic offence is contained in the Fraud Act 2006 and can be made out either through the making of a false or misleading representation, Fraud Act 2006, s.1(1)(2)(a) and s.2; or failing to disclose information that a person is legally obliged to disclose, Fraud Act 2006, s.1(1)(2)(b) and s.3; or by abusing a position occupied in relation to the financial interests of another, Fraud Act 2006, s.1(1)(2)(c) and s.4. If done dishonestly, Fraud Act 2006, s.2(1)(a), s.3(a), s.4(1)(b), and with an intention to make a gain for himself or another, or to cause a loss to another or to expose another to a risk of loss, Fraud Act 2006, s.2(1)(b)(i) and (ii), s.3(b)(i) and (ii), s.4(1)(c)(i) and (ii). A conviction can follow with a term of up to 10 years' imprisonment.

<sup>24</sup> New City Agenda and Cass Business School, "Cultural Change in the FCA, PRA and Bank of England, Practising What They Preach?", 25 October 2016 at [http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report\\_embargoed.pdf](http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report_embargoed.pdf) [Accessed May 21, 2017].

disclosure of sales commissions paid on these policies.<sup>25</sup> Numerous other mis-selling complaints include interest rate hedging schemes, packaged accounts, interest only mortgages, investments and other insurance products.<sup>26</sup> More recently, it has been suggested that liability for mis-selling pension annuities may prove to be as extensive as the personal protection insurance scandal.<sup>27</sup>

### **Legal problems of attribution hinder criminal prosecution**

The common law's approach to attributing criminal liability to companies, employing the so-called "identification principle", has posed serious difficulties. The common law foundation of criminal liability is traditionally expressed in the Latin maxim "*actus non facit reum nisi mens sit rea*"<sup>28</sup> which essentially means that "whatever the deed a man may have done, it cannot make him criminally punishable unless his doing of it was actuated by a legally blameworthy attitude of mind".<sup>29</sup> Further, in accordance with the criminal law's individualist ideal, the state of mind in question is determined subjectively rather than by reference to an objective standard of behaviour.<sup>30</sup> A review of the means by which criminal culpability can be attracted in the context of corporate activity reveals various possibilities. In the first instance, an individual employee may commit the substantive offence in question and attract individual liability, for example under s. 1 Fraud Act<sup>31</sup> for fraudulent activity of a proscribed type<sup>32</sup> or s. 1, 2 or 6 of the Bribery Act 2010 for an offence of bribery, being bribed or bribing a foreign public official. The liability is contained at the individual level, whether or not the misconduct was intended to benefit the company, unless the individual actor involved is so senior in the organisation that he is deemed to be its controlling mind.<sup>33</sup> In such a case, the company itself may also be criminally liable for the substantive offence under the "identification doctrine". Application of this doctrine means that a corporation can be found guilty of a substantive offence, for example fraud contrary to s. 1 Fraud Act or one of the bribery offences set out at ss. 1, 2 and 6 Bribery Act, the *mens rea*, namely the dishonesty and/or relevant intent, of the senior individual being attributable to the corporate entity itself. Further, if liability is attributed to the company under this doctrine, other company officers may attract culpability for the offence if they have consented to or connived in its

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<sup>25</sup> *Plevin v Paragon Personal Finance Ltd* [2014] UKSC 61. The Supreme Court held that the Consumer Credit Act 1974, ss.140A to 140D applied and the non-disclosure of the amount of commissions and the identity of the recipients did make the debtor-creditor relationship unfair under s.140A(1)(c) and the creditor may not have taken out the personal protection insurance had she known the amount of the commission charged.

<sup>26</sup> [www.financial-ombudsman.org.uk/news/speech/2013/CW-BILA-conference.pdf](http://www.financial-ombudsman.org.uk/news/speech/2013/CW-BILA-conference.pdf) [Accessed May 21, 2017].

<sup>27</sup> <http://www.telegraph.co.uk/finance/personalfinance/pensions/11286965/Annuity-mis-selling-scandal-could-it-be-as-big-as-PPI.html> [Accessed May 21, 2017].

<sup>28</sup> See, for example, Lord Kenyon CJ in *Fowler v Padget* (1798) 7 T.R. 509; Lord Goddard CJ in *Harding v Price* [1948] 1 K.B. 695.

<sup>29</sup> J.W. Cecil Turner, *Russell on Crime* (Stevens & Sons, 1964) Vol. 1.

<sup>30</sup> A recent example of the subjectivist tendency can be found in the criminal damage case of *R. v G.* [2004] 1 A.C. 1034 (HL) in which the objective test of recklessness was replaced in favour of a subjective test.

<sup>31</sup> Fraud Act 2006, s.1 and referring to ss.2, 3 and 4.

<sup>32</sup> In addition, if a business is carried out for a fraudulent purpose, statutory provisions impose liability under Companies Act 2006, s.993 and Fraud Act 2006, s.9 where an individual participates in a fraudulent business carried on by a sole trader.

<sup>33</sup> *Tesco v Natrass* [1972] A.C. 153 (HL).

commission.<sup>34</sup> As far as corporate liability is concerned, criminal culpability is restricted to cases in which the individual who is deemed to be the “directing mind and will” of the corporation, acting and speaking for it, is himself guilty of the offence.<sup>35</sup>

The construction of corporate liability on this basis is now dated in that it is premised in a notion of corporations comprising relatively simple, pyramidal managerial frameworks. This means that large companies with typically complex organisational structures and decentralised responsibility are likely to evade prosecution whereas smaller companies, with directors more likely to be involved in the day to day activities of the business, are convicted much more readily.<sup>36</sup> As a basis of fault, it can be said that the “identification principle” underestimates the complexity and subtlety of corporate action, imposing an already simplified biological model on an equally simplified appreciation of corporate management and behaviour.<sup>37</sup> In practice, corporate policy and decision-making is often decentralised or the product of other corporate policies and procedures rather than the result of individual decisions.<sup>38</sup> Indeed, the “identification principle” of liability attribution serves as a real incentive to senior managers to “turn a blind eye” to questionable or dubious practices and it acts as a disincentive for the internal reporting of suspected illegality.<sup>39</sup> Therefore, as a method of attributing criminal liability, “it fails to reflect the reality of the modern day large multinational corporation (...) [and] it produces what many regard as an unsatisfactory narrow scope for criminal liability”.<sup>40</sup> Furthermore, the need to identify the criminality of an individual of sufficient seniority, as a precursor to corporate prosecution, incurs evidential problems which inevitably increase as the size of the company increases.<sup>41</sup> In the absence of the involvement of an actor whose mind is deemed to be that of the organisation itself, corporations have not been liable for the crimes perpetrated by their employees or agents in the course of business, even where the offending activity is to the benefit of the organisation.<sup>42</sup> As a result of these limitations, bespoke statutory reforms have been enacted

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<sup>34</sup> For example, directors, managers, secretaries or similar or persons purporting to act in any such capacity will be equally culpable if the offence is proved to have been committed with their consent or connivance, see Fraud Act 2006, s.12(2)(a) and (b) and Bribery Act 2010, s.14.

<sup>35</sup> This terminology is attributed to Viscount Haldane, *Lennard’s Carrying Co Ltd v Asiatic Petroleum Ltd* [1915] A.C. 705 (HL).

<sup>36</sup> See, for example, the prosecution of the small company in *R. v Kite & OLL Ltd.*, 8 Dec 1994. T. Woolf, “The Criminal Code Act 1995 (Cth) - Towards a Realist Vision of Corporate Criminal Liability” (1997) *Criminal Law Journal* 257. See too, HMRC “Tackling offshore tax evasion: a new corporate criminal offence of failure to prevent the facilitation of evasion” (Consultation document, 16 July 2015).

<sup>37</sup> C. Harding, *Criminal Enterprise, Individuals, Organisations and Criminal Responsibility* (Willan, 2007) Ch 9.

<sup>38</sup> C.M.V. Clarkson, ‘Kicking Corporate Bodies and Damning Their Souls’ [1996] *Modern Law Review* 557, 561.

<sup>39</sup> HMRC “Tackling offshore tax evasion: a new corporate criminal offence of failure to prevent the facilitation of evasion”, (Consultation document, 16 July 2015).

<sup>40</sup> D. Ormerod, *Smith & Hogan’s Criminal Law* (Oxford: Oxford University Press, 2008) p. 249, a view shared by Gobert, see J. Gobert, “Corporate Criminality: four models of fault” (1994) 14(3) *Legal Studies* 393, 395.

<sup>41</sup> M. Hsaio, “Abandonment of the Doctrine of Attribution in favour of Gross Negligence Test in the Corporate Manslaughter and Corporate Homicide Act 2007” (2009) 30(4) *Company Lawyer* 110, 111.

<sup>42</sup> The need to find a “directing mind and will” with which to equate corporate blameworthiness is a relatively recent proposition emanating from the civil case of *H.L. Bolton (Engineering) Co Ltd v T.J. Graham & Sons Ltd.* [1957] 1 Q.B. 159 (CA) and followed in *Tesco Ltd v Nattrass* [1972] A.C. 153 (HL). Prior to this authority existed for the application of established agency principles to corporate liability, see A. Cronin, “Reforming Corporate Fraud Regulation in the UK: A Model of Manifest Liability”, PhD thesis, Bournemouth University (Taylor Francis,

in relation to corporate manslaughter,<sup>43</sup> bribery<sup>44</sup> and tax evasion<sup>45</sup> and reform is now proposed more broadly in other areas of economic crime.

The first significant innovation, the Corporate Manslaughter and Corporate Homicide Act 2007, introduced a distinct statutory basis for corporate liability where death arises as a consequence of a gross breach of the duty of care owed to the deceased by the organisation.<sup>46</sup> Subsequently, the Bribery Act 2010 imposed corporate criminal culpability on the basis of a failure of the organisation to prevent its employees or associated persons bribing another to the advantage of the organisation where there have been inadequate procedures in place to prevent the conduct.<sup>47</sup> The Bribery Act therefore works in tandem to the common law “identification doctrine”, the new statutory “failure to prevent” model adding to the type of corporate culpability that may be incurred by imposing corporate liability for ineffective control of “rogue” employees.

### **Government proposals for a new approach to “economic crime”**

In December 2014, the government published its UK Anti-Corruption Plan.<sup>48</sup> Whilst this focused specifically on bribery, corruption,<sup>49</sup> money laundering, and a number of highly particularised settings in which these crimes are perpetrated,<sup>50</sup> Action 36 set out a commitment to examine not only the case for a new offence of a corporate failure to prevent economic crime but also the rules on establishing corporate criminal liability more widely.<sup>51</sup> However, within just a year, on 28th September 2015, the Justice Minister, Andrew Selous, revealed that the Ministry of Justice had abandoned its work on corporate criminal liability for failure to prevent economic crimes<sup>52</sup>. The reasons given for this decision were two-fold: first, there had been no corporate prosecutions to date for the Bribery Act offence of failing to prevent bribery and, second, there was little evidence of corporate economic wrongdoing

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2017, forthcoming) *sub nom* “*Corporate Criminality and Liability for Fraud*” and the analysis of *Triplex Safety Glass Co Ltd. v Lancegaye Safety Glass (1934) Ltd.* [1939] 2 K.B. 395 (CA); *R v ICR Haulage Ltd* [1944] K.B. 551 (CCA); *Moore v Bresler Ltd.* [1944] 2 All E.R. 515.

<sup>43</sup> Corporate Manslaughter and Corporate Homicide Act 2007.

<sup>44</sup> Bribery Act 2010, s. 7.

<sup>45</sup> Criminal Finances Act 2017, Pt. 3, ss. 45 and 46.

<sup>46</sup> Corporate Manslaughter and Corporate Homicide Act 2007, s.1.

<sup>47</sup> Bribery Act 2010, s.7.

<sup>48</sup> HM Government “UK Anti-Corruption Plan”, (Dec. 2014).

<sup>49</sup> Although acknowledging there is no universally accepted definition of “corruption”, the UK Anti-Corruption Plan seems to accept that corruption is the abuse of power for personal gain, HM Government “UK Anti-Corruption Plan”, (Dec. 2014) p.9.

<sup>50</sup> For example, organised crime, corruption in government departments and agencies, corruption, jury nobbling, corruption at borders, corruption by MPs, local authorities, the MOD, sports and betting, financial services and in the context of financial markets. The Plan also looks at money laundering and terrorism and the proceeds of crime, and generally at whistle-blowing provisions, HM Government “UK Anti-Corruption Plan” (Dec. 2014).

<sup>51</sup> HM Government, “UK Anti-Corruption Plan” (Dec. 2014), p.14.

<sup>52</sup> <https://www.lawgazette.co.uk/news/government-drops-plan-to-extend-corporate-criminal-liability/5051277.article> [Accessed June 6, 2017].

going unpunished<sup>53</sup>. Despite this seeming lack of confidence in the new model, on 16 July 2015, HMRC proposed the introduction of a new corporate offence of failing to prevent the facilitation of offshore tax evasion by its agents.<sup>54</sup> Starting in 2016 for the Crown Dependencies and Overseas Territories and in 2017 for the remaining signatory countries, HMRC will receive detailed information about offshore accounts held by UK tax residents under the Common Reporting Standards.<sup>55</sup> The Finance Act 2016 introduced tougher sanctions with civil financial penalties and additional criminal offences for individual employees and/or associated persons who enable offshore tax evasion,<sup>56</sup> which will be built upon by the corporate “failure to prevent” offences in relation to both UK tax and foreign tax evasion in the Criminal Finances Act 2017.<sup>57</sup> The Organisation for Economic Cooperation and Development’s (OECD) Global Forum for Transparency and Exchange of Information for Tax Purposes, currently with 140 members, provides the practical framework within which the offence will be constructed.<sup>58</sup> In the meantime, the failure to prevent economic crimes project has been resurrected by the Ministry of Justice, which on 12 May 2016 announced that it would be consulting later in the year with a view to extending the “failure to prevent” model to fraud, false accounting and money-laundering.<sup>59</sup> That call for evidence took place in early 2017, closing on the 24 March 2017.<sup>60</sup>

The use of the terminology of “economic crime” to encompass issues of money-laundering, false accounting and fraud, whilst bribery and tax evasion are addressed under distinct measures, is to be regretted. There is a lack of logic using general terminology to cover money-laundering, false accounting and fraud whilst keeping other “economic” crimes, such as bribery and tax evasion, separate. It is submitted that the better solution would be to retain the status quo and reform the underlying legislation, for example, the Proceeds of Crime Act 2002, Terrorism Act 2000, Money-Laundering Regulations 2007 and Fraud Act 2006. Furthermore, the use of the term “economic” poses the risk that the very real human costs associated with these crimes may fail to be appreciated, they may be perceived as purely “economic” and victimless in nature. To take money-laundering as an example, the human costs associated with the practice may well include modern slavery, human trafficking and terrorist atrocities. The consequences of fraud may be less visible but, as has been identified above, may nonetheless include inestimable damage to people’s health and well-being through bankruptcy and other factors. The use of the term “economic crime” may also pose the risk of policy creep over time; it conjures up unfortunate connotations in its application in the former Soviet Union.<sup>61</sup>

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<sup>53</sup> Ibid, the Bribery Act 2010, which set out the innovative offence in s. 7, had come force on July 1, 2011 and therefore more than 4 years had then elapsed.

<sup>54</sup> HMRC “Tackling offshore tax evasion: a new corporate criminal offence of failure to prevent the facilitation of evasion” (Consultation document, 16 July 2015).

<sup>55</sup> This includes the name and address of the account holder, account numbers, interest and balances.

<sup>56</sup> Finance Act 2016, s.162 and Sch.20, s.166 inserting ss.106B to 106H into the Taxes Management Act 1970.

<sup>57</sup> Criminal Finances Act 2017, Pt 3, ss.45 and 46.

<sup>58</sup> <http://www.oecd.org/tax/transparency/> [Accessed May 9, 2017].

<sup>59</sup> <https://www.gov.uk/government/news/new-plans-to-tackle-corporate-fraud> [Accessed June 26, 2016].

<sup>60</sup> Ministry of Justice, “Call for Evidence on Corporate Liability for Economic Crime” 13 Jan. to 24 Mar. 2017.

<sup>61</sup> See, for example, “Economic Crimes under Soviet Law” (1951) University of Melbourne *Res Judicata*, 45.



## **Evaluation of the potential of a “failure to prevent” model to fraud in a financial services context**

This article will seek to evaluate whether the extension of the “failure to prevent” model, now employed in the Bribery Act 2010 and the Criminal Finances Act 2017, is likely to succeed in dealing with corporate fraud in a financial services context. This excludes an examination of its applicability to other offences since these are distinct in substance and therefore merit separate investigation. In particular, this article will analyse:

- (a) The problem of “economic crime”;
- (b) The historical development of the “failure to prevent” model of organisational liability for bribery;
- (c) Its relative effectiveness in the context of the Bribery Act 2010 and extension in the Criminal Finances Act 2017;
- (d) The relative ineffectiveness of the law in combatting fraud in a financial services context;
- (e) The appropriateness of the “failure to prevent” model to “economic crime”, specifically fraud in a financial services context; and
- (f) Make proposals for reform.

## **THE HISTORICAL DEVELOPMENT OF THE “FAILURE TO PREVENT” MODEL OF ORGANISATIONAL LIABILITY FOR BRIBERY**

### **The need to reform bribery law**

Given that bribery is a form of economic crime, it is of note that this particular offence was the subject of reform well in advance of the other forms now more generally identified. In this respect, the law of bribery is to be understood as the product of its genealogy, its origins and development wholly independent of the evolutionary paths of the law of fraud and other economic crimes. Bribery has also been treated in isolation at the international level and this distinction is reflected as much in the substance of the offence as in its enforcement<sup>62</sup> and the drivers for reform. Cases involving an offence called bribery first appeared in Star Chamber records circa 1550.<sup>63</sup> The common law offence of bribery of a public official sat alongside a number of other offences which prohibited conduct of this nature in highly particularised circumstances, for example misconduct in public office<sup>64</sup> and misconduct by executive and administrative officials of the crown.<sup>65</sup> Having evolved on a case by case basis, the common law offence of bribery of a public official encompassed the “receiving or offering [of] any

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<sup>62</sup> Dealt with below.

<sup>63</sup> J. Lindgren, “The Theory, History, and Practice of the Bribery-Extortion Distinction” (1993) *University of Pennsylvania Law Review*, Vol. 141: 1695 and referring to J.T Noonan Jr’s comprehensive work, *Bribes: The Intellectual History of A Moral Idea* (Diane Publishing Co, 1984).

<sup>64</sup> The Law Commission is currently analysing responses to its second public consultation process with a view to proposed reform of this offence, <http://www.lawcom.gov.uk/project/misconduct-in-public-office/> [Accessed May 15, 2017].

<sup>65</sup> See Law Commission, “Misconduct in Public Office, Issues Paper 1”, App. A, Jan 20, 2016, providing a detailed account of the historical developments of this offence and related offences.

undue reward by or to any person whatsoever, in a public office, in order to influence his behaviour in office, and incline him to act contrary the known rules of honesty and integrity.”<sup>66</sup> As regards its scope, precedent existed for the bribing of privy councillors, officers of justice and jurymen<sup>67</sup> and the elections of overseers of parishes, officers of companies and members of parliament.<sup>68</sup> However, with the growth of commercial activity in the late nineteenth and early twentieth century, there was a corresponding increase in corrupt behaviour and the reach of the law was extended with the introduction of various statutory offences.<sup>69</sup> The first, the Public Bodies Corrupt Practices Act 1889, was enacted largely in response to the revelation of widespread misconduct of local government and other public employees within London’s governing body, the Metropolitan Board of Works.<sup>70</sup> However, this statute did not address the growing problem of corruption in the private sector which was undermining confidence in trade and Parliament responded by passing the Prevention of Corruption Act 1906.<sup>71</sup> Criminalizing corruption between private individuals, the Act also extended the range of public officials who were caught by the law<sup>72</sup> but was itself limited by the requirement that the recipient of the corrupt payment was the “agent” of a “principal”. The definition of “agent” was construed within the ordinary meaning of the term, applicable to those who acted on behalf of others, and therefore could include employees, directors and trustees.<sup>73</sup> Within a decade, s. 4(3) of the Prevention of Corruption Act 1916 extended the definition of “agent” in the public sector context such that a person serving under any public body, whether or not an agent within the accepted meaning, was deemed to be an agent for the purposes of the 1906 Act.<sup>74</sup> Neither the 1889 Act<sup>75</sup> nor the 1906 Act<sup>76</sup> provided a definition of “corruptly”, an element that was central to the offending behaviour. In this respect, the courts relied upon the circular statement provided in *Cooper v Slade (1858)*<sup>77</sup> to the effect that it meant purposefully doing an act which the law forbids as tending to corrupt. Unsurprisingly, this proved problematic in practice and the 1916 Act also created a rebuttable presumption of corruption where gifts were made to public officials by those seeking a contract from the public body.<sup>78</sup>

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<sup>66</sup> J.W.C. Turner, *Russell on Crime* (Stevens, 1964) p.381.

<sup>67</sup> The now defunct offence was referred to as embracery.

<sup>68</sup> W.F. Craies and H.D. Roome, *Archbold’s Pleading, Evidence and Practice in Criminal Cases* (24<sup>th</sup> ed., Sweet & Maxwell, 1910) p.1195.

<sup>69</sup> R. Chada et al, *Bribery: A Compliance Handbook* (Bloomsbury Professional, 2014).

<sup>70</sup> R. Chada et al, *Bribery: A Compliance Handbook* (Bloomsbury Professional, 2014).

<sup>71</sup> The Prevention of Corruption Act 1906 came into force the following year.

<sup>72</sup> R. Chada et al, *Bribery: A Compliance Handbook* (Bloomsbury Professional, 2014).

<sup>73</sup> P. Murphy (ed.), *Blackstone’s Criminal Practice* (Oxford University Press, 2003) B15.13.

<sup>74</sup> P. Murphy (ed.), *Blackstone’s Criminal Practice* (Oxford University Press, 2003) B15.13. See also *Barrett* [1976] 1 W.L.R. 946.

<sup>75</sup> Public Bodies Corrupt Practices Act 1889, s.1(1) “Every person who shall by himself or by or in conjunction with any other person, corruptly solicit or receive, or agree to receive...” and s.1(2) “Every person who shall by himself or by or in conjunction with any other person corruptly give, promise or offer...”.

<sup>76</sup> Protection of Corruption Act 1906, s.1(1) “if any agent corruptly accepts or obtains..., or any person corruptly gives or agrees to give or offer...”.

<sup>77</sup> *Cooper v Slade* (1858) VI House of Lords Court (Clark’s) 746, 10 E.R. 1488 at 1499.

<sup>78</sup> Further to the enactment of Human Rights Act 1998, s.3 enshrining European Convention of Human Rights Art. 6(2), this shifts the evidential burden onto the defendant to raise the issue as to whether the gift was corruptly made, the burden of proof remaining with the prosecution.

Proposals for reform were put forward in the 1970's following the Poulson scandal,<sup>79</sup> the Radcliffe-Maud Committee recommending that the presumption of corruption should extend to cover elected officials who exercised discretion in areas such as housing and planning<sup>80</sup> and the Salmon Commission focusing on public sector issues.<sup>81</sup> These were not acted upon and a further scandal, the infamous "cash for questions" affair involving Mohamed Al-Fayed, the then owner of Harrods department store, sparked John Major's instigation of Lord Nolan's Commission of Inquiry in 1994.<sup>82</sup> It was at the suggestion of the Nolan Committee Report on Standards in Public Life<sup>83</sup> that the Law Commission made proposals for reform of the bribery offence in 1998.<sup>84</sup> However, the initial proposals were not adopted, largely due to the rejection of the proposed retention of the "agent" and "principal" basis for the offence<sup>85</sup> and reservations as to the alternatives that were subsequently mooted.<sup>86</sup> Referring the matter back for further review, the Law Commission published another report in 2008<sup>87</sup> and it was this that led to the enactment of the Bribery Act 2010.

A number of international initiatives were also emanating from various sources over this period and the domestic response to the problem of corruption and bribery must be viewed in this broader context. For example, as a member of the EU, the UK was subject to the First and Second Protocols to the Convention on the Protection of the European Communities' Financial Interests<sup>88</sup> and the Convention on the Fight against Corruption involving Officials of the European Communities or Officials of Member States of the EU Framework Decision of 22 July 2003.<sup>89</sup> Similarly, the UK ratified the Council of Europe's Criminal Law Convention on Corruption<sup>90</sup> in December 2003 and this necessitated the criminalisation of both domestic and public foreign officials when it came into force in April 2004.<sup>91</sup> In December 2005, the United Nations Convention against Corruption came into force

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<sup>79</sup> J. Poulson, architect, was convicted of conspiracy to make or receive corrupt gifts in a web of corruption extending to 23 local authorities and around 300 individuals including MPs, police officers, health authorities and civil servants, see [http://news.bbc.co.uk/onthisday/hi/dates/stories/march/15/newsid\\_4223000/4223045.stm](http://news.bbc.co.uk/onthisday/hi/dates/stories/march/15/newsid_4223000/4223045.stm) [Accessed May 22, 2017].

<sup>80</sup> Radcliffe-Maud Committee on Local Government Rules of Conduct 1974.

<sup>81</sup> Royal Commission (*The Salmon Commission*) on Standards in Public Life 1976, Cmnd. 6524.

<sup>82</sup> R. Chada et al, *Bribery: A Compliance Handbook* (Bloomsbury Professional, 2014).

<sup>83</sup> Nolan Committee, *Report on Standards in Public Life 1995* (Cm 28501).

<sup>84</sup> Law Commission, *Legislating the Criminal Code: Corruption* (Report No. 248), 3 March 1998.

<sup>85</sup> <http://www.legislation.gov.uk/ukpga/2010/23/notes> [Accessed 16.10.16], see Summary, para.4.

<sup>86</sup> See the Government's White Paper "Raising Standards and Upholding Integrity: the Prevention of Corruption" (Cm. 4759); Joint Committee on the Draft Corruption Bill Session 2002-03, Report and Evidence HL 157, HC 705 Dec 2003; The Government Reply to the Report from the Joint Committee on the Draft Corruption Bill Session 2002-03 HL 157, HC 705, Cm. 6068 and the Government consultation "Bribery: Reform of the Prevention of Corruption Acts and SFO powers in cases of bribery of foreign officials" (2005).

<sup>87</sup> Law Commission, *Reforming Bribery* (Report No. 313), 20 Nov 2008.

<sup>88</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=URISERV%3A133019> [Accessed May 22, 2017], the first protocol came into force on the 17 October 2002, the second on the 19 May 2009.

<sup>89</sup> R. Chada et al, *Bribery: A Compliance Handbook* (Bloomsbury Professional, 2014).

<sup>90</sup> Council of Europe, Treaty No. 173.

<sup>91</sup> [http://www.coe.int/t/DGHL/cooperation/economiccrime/corruption/Default\\_en.asp](http://www.coe.int/t/DGHL/cooperation/economiccrime/corruption/Default_en.asp) [Accessed May 22, 2017].

following a series of resolutions, declarations and conventions and the launch of the Global Programme against Corruption.<sup>92</sup> This was ratified by the UK in 2006, having signed up at an earlier high level conference in 2003.<sup>93</sup> Further, the Organisation for Economic Cooperation and Development (OECD), to which the UK acceded in 1961, enacted the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions in 1999.<sup>94</sup> In this respect, the OECD'S Working Group review of our national law found that the criminal law's response to corporate liability was wanting<sup>95</sup> and that although there were exceptions, our anti-corruption legislation was deficient in that it did not extend the jurisdiction of the UK courts to try cases abroad.

### **Common law precedents for a “failure to prevent” model generally unsuccessful**

The failure to *prevent* the criminal activities of other persons has not generally been regarded as a criminal offence.<sup>96</sup> There was a common law misdemeanour “misprision of felony”, involving a failure to *reveal* a felony to the authorities which in effect created a duty to reveal the commission of a crime. To attract liability it was not necessary to have done anything active in the commission of the offence,<sup>97</sup> however, it was also a misprision to fail to reveal another's *intention* to commit a future felony,<sup>98</sup> which comes very close to an offence of failing to prevent a felony. Perhaps understandably, this offence was regarded as unreasonably wide for a considerable period of time<sup>99</sup> such that it came to be regarded as “practically obsolete” in the nineteenth century.<sup>100</sup> That being said, four prosecutions for the failure to report the felony of another were successful in the twentieth century, the last being in 1961.<sup>101</sup> Although it had been suggested that the charge of misprision should only succeed on proof that the non-disclosure was for the benefit of the party charged,<sup>102</sup> this was rejected in *Wilde* [1960].<sup>103</sup> In *Sykes* [1961] Lord Denning accepted a number of limitations to prosecution for misprision, some of which were based on the nature of the relationship

<sup>92</sup> See the details provided at <https://www.unodc.org/unodc/en/treaties/CAC/> [Accessed May 22, 2017].

<sup>93</sup> <https://www.unodc.org/unodc/en/treaties/CAC/signatories.html> [Accessed May 22, 2017].

<sup>94</sup> [http://www.oecd.org/daf/anti-bribery/ConvCombatBribery\\_ENG.pdf](http://www.oecd.org/daf/anti-bribery/ConvCombatBribery_ENG.pdf) [Accessed May 22, 2017]. Art.1 criminalises the bribing of a foreign public official, Art.9 deals with mutual legal assistance and Art.10 with extradition.

<sup>95</sup> <http://www.oecd.org/daf/anti-bribery/anti-briberyconvention/34599062.pdf> [Accessed May 22, 2017], pp.63 – 66.

<sup>96</sup> It is still a common law offence to refuse to assist a constable who calls for assistance in dealing with a breach of the peace, *Brown* (1841) Car & M 314; *Waugh* (1976) *Times*, 1 Oct. 1976.

<sup>97</sup> *Sykes v DPP* [1961] 3 W.L.R. 371 (TAC), a person committed an offence if he knew of another's guilt, and could give information that might lead to his arrest for a felony, but omitted to communicate that information to some justice of the peace, see JW Cecil Turner, *Kenny's Outlines of Criminal Law* (Cambridge University Press, 1966).

<sup>98</sup> G. Williams, *Criminal Law, General Part* (Stevens & Sons, 1961) p.423.

<sup>99</sup> G. Williams, *Criminal Law, General Part* (Stevens & Sons, 1961) p.423, citing the Criminal Law Commissioners 5<sup>th</sup> Rep (184) *Parl. Pap.* xx 36.

<sup>100</sup> G. Williams, *Criminal Law, General Part* (Stevens & Sons, 1961) p.424, citing Stephen, HCL ii 238.

<sup>101</sup> *Casserley*, *Times*, May 28, 1938; *Aberg* [1948] 1 All E.R. 601, 32 CAR 144 (CCA); *Wilde* [1960] *Criminal Law Review* 116; *Sykes v DPP* [1961] 3 W.L.R. 371 (TAC).

<sup>102</sup> *Aberg* [1948] 1 All ER 601 and Lord Goddard's reference to Lord Westbury in *Williams v Bayley* (1866) L.R. 1 HL 220.

<sup>103</sup> *Wilde* [1960] *Criminal Law Review* 116.

between the parties involved which could give rise to a claim of right in good faith, for example that between lawyer and client, doctor and patient and clergyman and parishioner.<sup>104</sup> In addition, the institutional writers identified it as a misdemeanour to *forbear from preventing* a felony, however, this was regarded as narrower in scope than misprision and was long regarded as obsolete.<sup>105</sup> The offence of misprision of felony, but not misprision of treason,<sup>106</sup> was finally abolished by the Criminal Law Act 1967 which also brought to an end the distinction between felonies and misdemeanours, a distinction that had played a fundamental part in determining the scope of criminal liability for the misprision offence. The Criminal Law Revision Committee report of 1965, upon which the statute was based, had rehearsed a number of concerns with the misprision offence.<sup>107</sup> The Committee noted that the offence had no clearly defined limitations and, in particular, dishonesty was not a prerequisite to a conviction for the omission to report a felony. In addition, it was suggested that public opinion was unlikely to support an offence of refusing to answer police questions about the commission of offences and it then rejected the imposition of a general duty to disclose “for obvious reasons”.<sup>108</sup> Although not clarifying what those obvious reasons were, it has been suggested that this approach was based on the criminal law’s general dislike of liability based on omissions, a principle that had been cogently argued in the context of rescuers and the failure to save or attempt to save those in peril.<sup>109</sup> This argument was founded primarily on the incursion into the individual’s autonomy and liberty that such a duty would pose, noting that liability of this nature could arise by chance rather than choice. While supporters of social responsibility might have reasoned that a duty to disclose information is a minimal interference in comparison, the framers of the Criminal Law Act 1967 nonetheless followed the Law Committee’s recommendations.

In other contexts, there have been limited instances in which the common law, in effect, imposed criminal liability on individuals for a failure to prevent another’s offending but, where it has done so, the construction of the liability incurred is as an *accessory* to the substantive offence.<sup>110</sup> For example, a jury could infer that a mother intended to encourage or assist the sexual assault on her 12 year old son when she failed to prevent him from having sexual intercourse with an adult woman. The mother’s liability was based on her present knowledge of her son’s age and that he was unable to consent to the act.<sup>111</sup> Similarly, in *Carter v Richardson* [1974] the supervisor of a learner-driver who was above the blood-alcohol limit was found to have aided and abetted the drink-driving offence because he was

<sup>104</sup> *Sykes v DPP* [1961] 3 W.L.R. 371 (TAC).

<sup>105</sup> G. Williams, *Criminal Law, General Part* (Stevens & Sons, 1961) p.422 citing *Coney* (1882) 8 Q.B.D. 557-558 (CCR).

<sup>106</sup> D. Ormerod, *Blackstone’s Criminal Practice* (Oxford University Press, 2017) A1.16.

<sup>107</sup> Criminal Law Revision Committee, *Seventh Report on Felonies and Misdemeanours* (1965) (Cmnd. 2659) para.39.

<sup>108</sup> S. Wallerstein, “Imposing Obligations to Disclose Information on Non-Suspects” in G.R. Sullivan and I. Dennis (eds.) *Seeking Security: Pre-Emptying the Commission of Criminal Harms* (Hart, 2012).

<sup>109</sup> S. Wallerstein, “Imposing Obligations to Disclose Information on Non-Suspects” in G.R. Sullivan and I. Dennis (eds.) *Seeking Security: Pre-Emptying the Commission of Criminal Harms* (Hart, 2012).

<sup>110</sup> See for example the discussion by D.J. Baker in *G. William’s Textbook of Criminal Law* (Sweet & Maxwell, 2015) p.610-12.

<sup>111</sup> *State v Ainsworth* (1993) 426 S.E. 2d 410.

aware that the driver had consumed excessive alcohol or was reckless as to whether he had done so.<sup>112</sup> However, the application of this construction to establish a corporate accessorial liability, under the Accessories and Abettors Act 1861 or the Serious Crime Act 2007, is problematic in that proof of some blameworthy mental state, intention, knowledge or recklessness, is required. Aside from the statutory exceptions found in relation to corporate manslaughter,<sup>113</sup> the failure to prevent bribery<sup>114</sup> and tax evasion<sup>115</sup> the common law will only impose corporate culpability if the substantive offence in question has been committed by a sufficiently senior controlling officer within the organisation.<sup>116</sup> Therefore, in order to attribute secondary liability to a corporation in this way, it would be necessary to find that an individual senior manager/director had been criminally complicit through aiding, abetting, counselling or procuring another to commit the crime or in the assisting or encouraging of it.<sup>117</sup>

### **Statutory intervention to impose organisational liability based on failure to act**

Modern legislation has imposed a criminal liability for failure to *disclose information* in two key areas. The first relates to acts of terrorism or its funding, for example, under sections 19 and 21A Terrorism Act 2000, and the second relates to knowledge or suspicion of money laundering under sections 330, 331 and 332 Proceeds of Crime Act 2002.<sup>118</sup> Application of the latter is confined specifically to persons working in the regulated sector where the defendant knows, suspects or has reasonable grounds for knowing or suspecting that another is engaged in money laundering.<sup>119</sup> In essence, this imposes a duty to report and the “reasonable grounds for knowing or suspecting” limb means that a conviction can be based on a finding that although the defendant did not suspect laundering activity, he should have done. This duty is underpinned by the higher standard of diligence imposed by the Money Laundering Regulations 2007 which require comprehensive preventative systems within the regulated sector. The offences contained in the Money Laundering Regulations 2007<sup>120</sup> begin to get closer to a “failure to prevent” model by requiring that “relevant persons”<sup>121</sup> who are acting in the course of business conducted by them in the UK take appropriate steps to *detect and prevent* money laundering and the financing of terrorism.<sup>122</sup> In terms of the duty this imposes, there is a specific requirement to put in place and apply “customer due diligence”

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<sup>112</sup> *Carter v Richardson* [1974] R.T.R. 314.

<sup>113</sup> Corporate Manslaughter and Corporate Homicide Act 2007, s.1.

<sup>114</sup> Bribery Act 2010, s.7.

<sup>115</sup> Criminal Finances Act 2017, Pt.3, ss.45 and 46

<sup>116</sup> *Tesco v Natrass* [1972] A.C. 153 (HL).

<sup>117</sup> See the Accessories and Abettors Act 1861, s.8 and the Serious Crime Act 2007, ss.44-46.

<sup>118</sup> The 2002 Act came into force on February 24, 2003 and money laundering activity taking place prior to its commencement is subject to prosecution under the Criminal Justice Act 1988 for non-drugs offences or the Drug Trafficking Act 1994 for property derived from drugs offences.

<sup>119</sup> Proceeds of Crime Act 2002, ss.330, 331, 332.

<sup>120</sup> S.I. 2007, No 2157, in accordance with the EU 3<sup>rd</sup> Money Laundering Directive 2005, to be superseded by the 4<sup>th</sup> Anti-Money Laundering Directive (EU) 2015/849 which took effect on 26 June 2015, supplemented by the Reg. (EU) 2016/675 of 14 July 2016, which must be transposed into national law by 26 June 2017.

<sup>121</sup> Money Laundering Regulations 2007, reg.3.

<sup>122</sup> D. Ormerod, *Blackstone's Criminal Practice* (OUP 2015), B21.32 emphasis added.



measures with an accompanying duty to effect internal controls, training and monitoring systems that are appropriate to the business in question, determined on a risk-based approach, and to report suspicious activities. Non-compliance gives rise to a civil penalty<sup>123</sup> and the offence is committed if the relevant person and/or regulated business fails to comply with one of the specified duties<sup>124</sup> although there is a defence that the accused took all reasonable steps and exercised all due diligence to avoid committing the regulatory offence.<sup>125</sup> The corporate criminal behaviour is therefore the failure to comply with the detailed administrative requirements stipulated in the Regulations, this being the substantive offence. Accordingly, to describe the offence in terms of the failure to prevent money laundering affords considerable artistic licence as regards the specific underlying basis for the attribution of fault. Indeed, veering to the other extreme, the Financial Conduct Authority's ("FCA") recent report of Barclays' failure to comply with the enhanced due diligence requirements,<sup>126</sup> in a £1.88bn transaction undertaken for a number of politically exposed persons, described the conduct as a failure to "minimise a risk that it might be used to facilitate financial crime"<sup>127</sup> while the popular press described a record fine "for secret deals with mega-rich", omitting any express reference to money-laundering or the Regulations themselves.<sup>128</sup>

As regards the duty to disclose, it is suggested that this is legitimated by the fact that those who are under the duty, i.e. who work in the regulated sector, actively help, even if unknowingly, to launder money and they are in a special relationship which gives rise to concerns of conflicts of interests.<sup>129</sup> Accordingly, legislation and regulation in this area seek to strike a balance between the duties owed to the client and those owed to the state<sup>130</sup> while giving effect to EU law.<sup>131</sup> However, it must be remembered that liability for failure to disclose the offence of another and liability for the failure to prevent the commission of an offence by another are ontologically distinct. While the former imposes a responsive and arguably minimal obligation on the duty holder to report to the relevant authority, by comparison the latter imposes a potentially onerous duty to actively construct such prophylactic measures as may be considered reasonable in the circumstances.

### **The development of the "failure to prevent" model for bribery**

The Law Commission's 2008 Report on *Reforming Bribery* naturally acknowledged both

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<sup>123</sup> Money Laundering Regulations 2007, reg.42.

<sup>124</sup> Money Laundering Regulations 2007, regs.45 and 47.

<sup>125</sup> Money Laundering Regulations 2007, regs.45(4) and 47.

<sup>126</sup> Money Laundering Regulations 2007, reg.14(1).

<sup>127</sup> <http://www.fca.org.uk/news/fca-fines-barclays-72-million-for-poor-handling-of-financial-crime-risks> [Accessed May 22, 2017].

<sup>128</sup> *Daily Mail*, 27 Nov., 2015.

<sup>129</sup> S. Wallerstein, "Imposing Obligations to Disclose Information on Non-Suspects" in G.R. Sullivan and I. Dennis (eds.) *Seeking Security: Pre-Emptying the Commission of Criminal Harms* (Hart, 2012).

<sup>130</sup> S. Wallerstein, "Imposing Obligations to Disclose Information on Non-Suspects" in G.R. Sullivan and I. Dennis (eds.) *Seeking Security: Pre-Emptying the Commission of Criminal Harms* (Hart, 2012).

<sup>131</sup> S.I. 2007, No 2157, in accordance with the EU 3<sup>rd</sup> Money Laundering Directive 2005, to be superseded by the 4<sup>th</sup> Anti-Money Laundering Directive (EU) 2015/849 which took effect on 26 June 2015, supplemented by the Reg. (EU) 2016/675 of 14 July 2016, which must be transposed into national law by 26 June 2017.

national and international obligations and influences.<sup>132</sup> It recognised that the creation of a new criminal offence incurred a heavy burden of justification, which it sought to meet in the following way.<sup>133</sup> It concluded that the criminal law needed strengthening in preference to modifying the civil law because an actionable damage may not be suffered when bribery is committed<sup>134</sup>. This finding directly reflected the OECD's requirement that criminal liability be imposed where there is no effective "tort" of bribery or special administrative sanction aimed at its prevention.<sup>135</sup> Of course, there are considerable limitations to bringing any civil action for this type of activity in English law which are primarily consequent on the construction of the wrongdoing itself and context in which it takes place, typically within the tight confines of an agency or fiduciary relationship. Accordingly, the civil law recognises that a principal may suffer an actionable loss as a result of his agent's breach of fiduciary duty or his unjust enrichment. Of note, the giving or the receiving of a bribe is not a distinct "tort" in itself, but is one of any number of different activities that could compromise the fiduciary duty or give rise to an unjust enrichment.<sup>136</sup> Although the fiduciary duties themselves are prophylactic in nature, there must be an identifiable and quantifiable loss for a claim of this nature to be actionable and, while the value of the secret commission itself may be readily established, quantifying the extent of the loss caused by the fraud is inevitably fraught with difficulty. Similarly, although liability for conduct of this type may be extended to third parties, this would need to be established on the basis of an unlawful means conspiracy involving proof of an agreement to some active or passive concerted action to cause damage<sup>137</sup> to another by unlawful means.<sup>138</sup> Accordingly, persons with *locus standi* to bring a civil action for bribery are strictly limited to those who have suffered a demonstrable direct financial loss, identified targets of an unlawful means conspiracy and/or those to whom injury was reasonably foreseeable in the course of the agreed activity. With the latter constraint in mind, the Law Commission concluded that a corporation, and those acting on its behalf, are better placed to ensure that the damage done by tolerating bribery is reduced or eliminated worldwide – especially in relation to overseas trade.<sup>139</sup>

Militating further towards the invocation of a criminal liability, the Law Commission also observed that the ambition of the EU Conventions was not adequately reflected in the civil jurisdiction, where the aim of the law of tort is primarily to restore parties to the financial position they were in before the loss.<sup>140</sup> The Law Commission also rejected the possibility that minority shareholders could bring an action against the corporate tolerance of unethical practice, referring to potential obstacles and the lack of evidence that actions of this nature

<sup>132</sup> Law Commission, *Reforming Bribery* (2008).

<sup>133</sup> Law Commission, *Reforming Bribery* (2008), para.6.13.

<sup>134</sup> Law Commission, *Reforming Bribery* (2008), para.6.13.

<sup>135</sup> Law Commission, *Reforming Bribery* (2008), para.6.68.

<sup>136</sup> *Petrotrade Inc v Smith* [2000] 1 Lloyd's Rep. 486, [2000] C.L.C. 916.

<sup>137</sup> This can be an intention to cause damage to the target or where it is reasonably foreseeable that injury will be caused.

<sup>138</sup> *Prudential Assurance Co Ltd v Newman Industries (No. 2)* [1982] Ch. 204 (CA). Of note, a corporate body can also be a party to such a conspiracy and this liability can be imposed on the basis of Nelsonian knowledge / wilful blindness, *Commissioners for HM Revenue and Customs v Sunico A/S* [2013] E.W.H.C. 941 (Ch).

<sup>139</sup> Law Commission, *Reforming Bribery* (2008), para.6.14.

<sup>140</sup> Law Commission, *Reforming Bribery* (2008), para.6.67.



are, or could be, used effectively to hold company Boards to account.<sup>141</sup> Thus, to accord with the spirit of our international obligations, the UK needed to adopt a more preventative approach by providing an enhanced means of deterrence and punishment to companies indifferent to the commission of bribery.<sup>142</sup> Further, the preference for criminalization over regulation was underlined by reference to the character of the misconduct in question, contrasting “parking offences, many environmental or licensing offences, and offences connected with, for example, failures to file accounts in a particular form” as examples of regulatory offences.<sup>143</sup> Providing further elucidation, the Law Commission opined that regulatory offences often target conduct that involves no harm in itself but which is conducive to harmful, risky or wrongful outcomes, for example parking on a double yellow line.<sup>144</sup> In support, three of the four consultees who responded did not believe that regulation enforced by non-criminal sanctions was the best way to address lack of corporate supervision.<sup>145</sup>

## **THE RELATIVE EFFECTIVENESS OF THE FAILURE TO PREVENT MODEL IN THE CONTEXT OF THE BRIBERY ACT 2010 AND ITS EXTENSION IN THE CRIMINAL FINANCES ACT 2017**

### **Structure of legislation**

The common law bribery offence and the patchwork of statutory provisions were repealed when the Bribery Act 2010 came into force on 1 July 2011. Although the Act retains the distinctions between active and passive bribery,<sup>146</sup> liability is not limited by reference to the particular status of the individuals involved and is determined by nature of the consequent act or that intended. Accordingly, the offer and/or acceptance of the advantage, financial or other, are deemed criminal bribery if done with an intention that the recipient will perform a relevant function or activity improperly.<sup>147</sup> The territorial limitation is addressed by s. 6 which specifically criminalises the bribery of a foreign public official and corporate responsibility is set out at s. 7 with the failure to prevent bribery offence. The Bribery Act “failure to prevent” offence,<sup>148</sup> with the accompanying adequate procedures/due diligence defence,<sup>149</sup> is, however, very different to previous common law attempts to develop liability based on a failure to prevent criminal acts and can instead be seen quite simply as the application of a well-established model of *regulatory* liability that developed in parallel. It is

<sup>141</sup> Law Commission, *Reforming Bribery* (2008), para.6.68.

<sup>142</sup> Law Commission, *Reforming Bribery* (2008). There are 4 European Conventions requiring liability for bribery and an inadequate failure to supervise an employee (or other person) who has committed bribery: Art.3(2) Second Protocol of the Convention on the Protection of the European Community’s Financial Interests; Art.18(2) Council of Europe’s Criminal Law Convention on Corruption; Art.5(2) European Council’s Framework Decision 2003/568/JHA; OECD Antibribery Convention.

<sup>143</sup> Law Commission, *Reforming Bribery* (2008), para.6.17.

<sup>144</sup> Law Commission, *Reforming Bribery* (2008), para.6.18.

<sup>145</sup> Law Commission, *Reforming Bribery* (2008), para.6.70.

<sup>146</sup> Criminalized at Bribery Act 2010, ss.1 and 2 respectively.

<sup>147</sup> Bribery Act 2010, s.3.

<sup>148</sup> Bribery Act 2010, s.7(1).

<sup>149</sup> Bribery Act 2010, s.7(2).

also very different to the failure-based offences in the Money Laundering Regulations in that it does not turn on a failure to comply with a detailed framework of administrative measures but is framed specifically on the failure to prevent an employee or associate committing the substantive bribery offence.<sup>150</sup> Further, in relation to the corporate bribery offence, the company itself must determine what internal procedures need to be invoked in order meet the adequacy test for prevention encompassed in the statutory “due diligence” defence, there are no explicitly prescribed measures.<sup>151</sup> The novelty of the Act therefore lies in the creation of a serious corporate offence combined with a defence that is effectively the demonstration of regulatory-type compliance, this construction now blurring the criminal and the regulatory categories in a penal statute.<sup>152</sup>

## Evaluation of the Bribery Act 2010

Five years on, there are mixed messages as to whether the Bribery Act is proving a success. For example, some commentators have described a “step change in anti-bribery compliance standards”<sup>153</sup> and note that, in spite of predictions that UK companies would be seriously disadvantaged on the global stage, the UK economy is the strongest in Europe.<sup>154</sup> Similarly, in terms of awareness and impact of the new provisions, a survey conducted in January 2014 found that 66% of SMEs had either heard of the Bribery Act 2010 or were aware of its corporate liability for failure to prevent bribery, with that awareness increasing slightly among those exporting to less developed regions, including the Middle East, Asia, Africa and South and Central America.<sup>155</sup> Of the 66% aware of the Act, 81% knew that the Act has extra-territorial reach and 72% thought that their company had sufficient understanding to be able to implement adequate anti-bribery procedures.<sup>156</sup> Impressive as this may sound, put another way it meant that less than half of the SMEs surveyed had enough knowledge to take sufficient steps some two and half years after the Act came into force. Of some concern is the report published in October 2016 by Professor Kakabadse, Henley Business School, which

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<sup>150</sup> Bribery Act 2010, s.1 or s.6.

<sup>151</sup> Bribery Act 2010, s.7(2). As regards guidance in relation to this matter see <https://www.justice.gov.uk/downloads/legislation/bribery-act-2010-guidance.pdf> [Accessed May 22, 2017].

<sup>152</sup> S. Gentle, “The Bribery Act 2010” [2011] *Criminal Law Review* 101.

<sup>153</sup> <http://www.out-law.com/en/articles/2015/april/five-years-ofn-the-bribery-act-has-led-to--a-step-change-in-anti-bribery-compliance-standards-says-expert/> [Accessed May 22, 2017], by B. Vitou, an anti-bribery expert at Pinsent Masons, LLP.

<sup>154</sup> <https://www.icsa.org.uk/ireland/knowledge-and-guidance/governance-and-directors/report-on-awareness-and-impact-of-the-uk-bribery-act-2010-among-small-and-medium-sized-enterprises-published> [Accessed May 22, 2017].

<sup>155</sup> Department for Business, Innovation and Skills (BIS, which became the Department for Business, Energy and Industrial Strategy in July 2016) and the Ministry of Justice, “Report on awareness and impact of the UK Bribery Act 2010 among small and medium sized enterprises”, 25 Sept. 2015, at <https://www.gov.uk/government/publications/impact-of-the-bribery-act-2010-on-smes> [Accessed May 22, 2017].

<sup>156</sup> Department for Business, Innovation and Skills (BIS, which became the Department for Business, Energy and Industrial Strategy in July 2016) and the Ministry of Justice, “Report on awareness and impact of the UK Bribery Act 2010 among small and medium sized enterprises”, 25 Sept. 2015, at <https://www.gov.uk/government/publications/impact-of-the-bribery-act-2010-on-smes> [Accessed May 22, 2017].

suggests that bribery is a “way of life” for British companies working in emerging markets, with an estimated 85% of managers forced to resort to it in order to do business, often with the tacit permission of their chief executives.<sup>157</sup> While acknowledging that the robust penalties contained in the UK Bribery Act and the US Foreign Corrupt Practices Act “bring fear to boards”, he suggested that they are also creating a new class of “fall guys”. These findings, based on a 12-year inquiry comprising of “intimate discussions” with over 900 executives,<sup>158</sup> are in contrast to other recent reports which indicate an increased awareness of bribery which may be attributable to the numerous high-profile corruption cases involving major US and European corporations<sup>159</sup> or the recent corporate investigations which are being undertaken by the Serious Fraud Office in the UK. According to the report published by PWC as a part of its Global Crime Survey 2016,<sup>160</sup> UK respondents reported that the overall level of bribery and corruption has fallen since 2014 with 98% stating that their company’s management were clear in their condemnation of the practice, and 94% believing that their company would rather have a business transaction fail than resort to bribery to secure it.<sup>161</sup> On a global perspective, the outlook is less optimistic with Ernst & Young’s report showing no improvement since 2014 and 39% of those surveyed perceiving that bribery is widespread in their countries. In the emerging markets this equated to 51% of respondents thinking that bribery occurs widely and in the developed markets 21% reported that such behaviour is widespread.

Notwithstanding, the perception of a high incidence of corrupt behaviour in both developed and emerging markets, there has been just one conviction for the corporate offence of failure to prevent bribery<sup>162</sup> to date and three Deferred Prosecution Agreements.<sup>163</sup> Deferred

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<sup>157</sup> See the media reports at <http://www.telegraph.co.uk/business/2016/10/26/bribery-a-way-of-life-for-companies-operating-in-emerging-market/> [Accessed May 22, 2017]; <http://www.lexology.com/library/detail.aspx?g=d44e6b4f-df0f-409f-ab82-b73654b1fdc7> [Accessed May 22, 2017].

<sup>158</sup> <http://www.telegraph.co.uk/business/2016/10/26/bribery-a-way-of-life-for-companies-operating-in-emerging-market/> [Accessed May 22, 2017]; <http://www.lexology.com/library/detail.aspx?g=d44e6b4f-df0f-409f-ab82-b73654b1fdc7> [Accessed May 22, 2017].

<sup>159</sup> For example in the Ernst & Young Global Fraud Survey 2016 and commenting in particular on the worsening view in developed markets, at <http://www.ey.com/gl/en/services/assurance/fraud-investigation---dispute-services/ey-global-fraud-survey-2016> [Accessed May 22, 2017].

<sup>160</sup> <http://www.pwc.com/gx/en/services/advisory/consulting/forensics/economic-crime-survey.html> [Accessed May 22, 2017].

<sup>161</sup> <http://www.pwc.com/gx/en/services/advisory/consulting/forensics/economic-crime-survey.html> [Accessed May 22, 2017].

<sup>162</sup> Sweett Group PLC pleaded guilty to the corporate offence on 18 Dec. 2015, contrary to Bribery Act 2010, s.7.

<sup>163</sup> On 30 Nov. 2015, Sir B. Leveson approved the first DPA between the Serious Fraud Office and ICBC Standard Bank Plc for acting with its sister company, Stanbic Bank Tanzania Ltd. to bribe Tanzanian government officials, see for example the report by Ashurst LLP on Global ABC and investigations, 18 Jan. 2016 at [https://www.ashurst.com/doc.aspx?id\\_Content=12763](https://www.ashurst.com/doc.aspx?id_Content=12763) [Accessed May 22, 2017]. The second DPA was approved on July 8, 2016, also by Leveson LJ, the counterparty is a UK SME that cannot be named because of ongoing related legal proceedings and is therefore referred to as XYZ Ltd, see <https://www.sfo.gov.uk/2016/07/08/sfo-secures-second-dpa/> [Accessed May 22, 2017]. The third DPA was agreed on Jan. 17, 2017 with Rolls Royce, <https://www.sfo.gov.uk/2017/01/17/sfo-completes-497-25m-deferred-prosecution-agreement-rolls-royce-plc/> [Accessed May 16, 2017]. A fourth DPA was agreed on Apr. 10, 2017 between the SFO and Tesco Stores Ltd but the details of the criminal activity to which this relates are

Prosecution Agreements (DPA) became part of the Serious Fraud Office's (SFO) enforcement armoury in February 2014 and can be invoked, with judicial approval, once criminal proceedings have been instituted against a corporation. In essence, the effect is that the prosecution is deferred on terms, such as the payment of a financial penalty, compensation and the implementation of a compliance programme. If the terms of the agreement are met within the specified time, the proceedings are discontinued.<sup>164</sup> Further, in October 2014 sentencing guidelines on financial penalties for companies convicted of economic crimes came into force and these will also inform the level of any financial penalty that forms part of a DPA.<sup>165</sup> Thus, for example, in February 2016, Sweett Group PLC was fined £1.4m on conviction<sup>166</sup> and, in November 2015, Standard Bank was given a US Dollar 16.8m fine as a term of its DPA.<sup>167</sup>

The lack of prosecutions for the s. 7 corporate failure to prevent bribery to date is not necessarily indicative of particularly low incidents of economic crime of this nature. It must be remembered that the Bribery Act 2010 came into force just over 5 years ago, does not have retrospective effect and the corporate model of criminal liability it employs is an innovation lacking any equivalent in the earlier anti-bribery regime. The provisions can only be invoked for failures occurring since July 2011. Accordingly, in January 2016, in the case referred to as “chickengate”, Smith & Ouzman Ltd. was convicted of 3 counts of corruption but, because the bribes had taken place between November 2006 and December 2010, this was prosecuted under s. 1(1) of the Prevention of Corruption Act 1906.<sup>168</sup> This corporate conviction, the first for offences involving bribery of foreign public officials, would have been established through the longstanding common law identification principle, with both the Chairman and the Sales and Marketing Director having been found guilty of the offences.<sup>169</sup> Similarly, investigations of this nature are inevitably long-running. The Smith & Ouzman case, for example, was concluded in January 2016 having been opened in October 2010, the first hearing not taking place until some 3 years later, in October 2013. The same can be said even in cases where the defendant organisation self-reports to the SFO. Thus, for example, where Sweett Group Plc had self-reported in July 2014, it was not until some 17 months later,

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currently the subject of reporting restrictions, <https://www.sfo.gov.uk/2017/04/10/sfo-agrees-deferred-prosecution-agreement-with-tesco/> [Accessed May 16, 2017].

<sup>164</sup> Crime and Courts Act 2013, Sch.17 and The Criminal Procedure Rules 2015, Pt.11.

<sup>165</sup> [https://www.sentencingcouncil.org.uk/wp-content/uploads/Fraud\\_bribery\\_and\\_money\\_laundering\\_offences\\_-\\_Definitive\\_guideline.pdf](https://www.sentencingcouncil.org.uk/wp-content/uploads/Fraud_bribery_and_money_laundering_offences_-_Definitive_guideline.pdf) [Accessed May 22, 2017].

<sup>166</sup> With an additional £851, 152.23 confiscated and £95,031.97 ordered in costs, <https://www.sfo.gov.uk/2016/02/19/sweett-group-plc-sentenced-and-ordered-to-pay-2-3-million-after-bribery-act-conviction/> [Accessed May 22, 2017].

<sup>167</sup> It also had to pay back the bribe of US \$6million plus interest, disgorge the profit of \$8.4million and pay the SFO's legal costs. See <https://www.sfo.gov.uk/2015/11/30/sfo-agrees-first-uk-dpa-with-standard-bank/> [Accessed May 22, 2017].

<sup>168</sup> <http://www.printweek.com/print-week/news/1148334/smith-ouzman-denies-paying-gbp400k-bribes-chickengate> [Accessed May 22, 2017]. The case became known as “chickengate” because of the frequency with which “chicken” as a pseudonym for “bribe” was used in the correspondence relied upon in evidence at trial.

<sup>169</sup> <https://www.sfo.gov.uk/2014/12/22/uk-printing-company-two-men-found-guilty-corruption-trial/> [Accessed May 22, 2017].

on the 18 December 2015, that a guilty plea was finally entered.<sup>170</sup> Although the company had invited the involvement of the SFO, it appears that the company ceased to be considered co-operative on the basis that, following legal advice, it had continued to undertake its own independent investigation.<sup>171</sup> However, in the Standard Bank case, where the defendant company was seen to co-operate sufficiently to be granted a DPA on 30 November 2015, the self-referral had been made after suspicions were raised in March 2013, some 2 years and 8 months earlier.

While only 2 corporate proceedings had been brought under the Bribery Act 2010 by the end of 2015, the SFO had opened 16 new investigations that year and there are currently a number of ongoing inquiries which relate to activity preceding and post-dating the coming into force of the Bribery Act 2010. These include Airbus Group, Alstom, ENRC, FH Bertling, GlaxoSmithKline, KBR and Unaoil.<sup>172</sup> Perhaps indicative of the growing appetite for robust anti-bribery action, in May 2015 the International Corruption Unit was created as part of the UK Anti-Corruption Plan with a view to a significant increase in investigations and a higher likelihood of prosecution.<sup>173</sup> It is reasonable to expect that the increasing publicity of investigative actions and enforcement measures being taken, in increasingly high-profile corporate cases, will continue to diminish the knowledge and awareness deficit that has been identified in relation to the anti-bribery offences. Publicity will also serve to illustrate, as it did in the Standard Bank proceedings, that a purely tick-box approach to corporate anti-bribery and corruption policy is not enough to demonstrate that due diligence has been exercised and to avoid penalty.

The “failure to prevent” model not only side-steps the problematic attribution of corporate fault inherent in the identification doctrine, the placing of the evidential onus on the corporate defendant to show due diligence also goes a long way to overcome practical difficulties that are particularly exacerbated in the corporate context. The problem of evidence is further alleviated with the availability of the Deferred Prosecution Agreement, and accompanying opportunity for a reduction in penalty, which serves as a strong incentive to self-report when companies discover that their anti-bribery regime has been ineffective.

### **Further development of model in the Criminal Finances Act 2017**

The corporate offence for failure to prevent offshore tax evasion introduced by the Criminal Finances Act 2017 goes further than the model in the Bribery Act in two important respects<sup>174</sup>. First, the substantive bribery offence is committed by the employee of, or person associated with, the commercial organisation itself and the imposition of corporate culpability

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<sup>170</sup> See the discussion in Ashurst LLP, “Bribery and corruption; what now for 2016?”, 18 Jan. 2016 at [https://www.ashurst.com/doc.aspx?id\\_Content=12763](https://www.ashurst.com/doc.aspx?id_Content=12763) [Accessed May 22, 2017].

<sup>171</sup> [https://www.ashurst.com/doc.aspx?id\\_Content=12763](https://www.ashurst.com/doc.aspx?id_Content=12763) [Accessed May 22, 2017].

<sup>172</sup> <https://www.sfo.gov.uk/our-cases/> [Accessed May 16, 2016].

<sup>173</sup> <http://www.nationalcrimeagency.gov.uk/about-us/what-we-do/economic-crime/international-corruption-unit-icu> [Accessed May 22, 2017]. This combined the remits of the Metropolitan Police Proceeds of Corruption Unit, the City of London Police Overseas Anti-Corruption Unit and elements of the National Crime Agency Economic Crime Command.

<sup>174</sup> Compare Criminal Finances Act 2017, Pt 3, ss.45 and 46 with Bribery Act 2010, s.7.

for “failure to prevent” rests on a 2-step process. In contrast, corporate liability for failure to prevent the facilitation of tax evasion is premised on a substantive offence being committed by a client of the firm and requires a 3-step process. In the first step, it must be established that there is a substantive criminal offence committed at taxpayer level, for example the common law crime of cheating the public revenue, or conspiracy to do so, or one of the range of statutory fraudulent evasion offences.<sup>175</sup> The second step requires that a person associated with the company, acting in his professional capacity, has criminally facilitated the taxpayer’s evasion of tax. This may be any offence pursuant to which a person is knowingly concerned, for example the fraudulent evasion of income<sup>176</sup> or other form of tax, or dishonestly taking “steps with a view” to tax evasion,<sup>177</sup> or through established “aiding, abetting, counselling or procuring” principles of secondary criminal liability.<sup>178</sup> The consequential corporate liability is predicated on the third step of proof of substantive criminal activity by both the taxpayer and the associated person providing services for or on behalf of the corporation, though neither the prosecution nor the conviction of either individual are prerequisites. In this respect, HMRC’s stated policy is to deal with fraud by using Civil Investigation of Fraud procedures, preferring the encouragement of full and honest voluntary disclosure under Contractual Disclosure Facility arrangements and the subsequent imposition of civil penalties.<sup>179</sup> From 1 January 2017, the civil penalties were extended to enablers of the offshore tax evasion.<sup>180</sup>

In that a finding of corporate liability for “failure to prevent” does not rest on criminal action being taken in relation to the underlying substantive tax offences of the taxpayer and the enabler, this approach accords with that taken to criminal liability for a corporate failure to prevent bribery. However, given the shift from a 2-step to a 3-step approach in the latter context, it may be argued that corporate liability for tax evasion is even more remote than that established under the Bribery Act,<sup>181</sup> with one of the offenders being a party not once but twice removed from the organisation itself. Further, unlike the corporate failure to prevent bribery offence,<sup>182</sup> there is no requirement to show that the individual agent facilitating the evasion was acting for the benefit of the corporation. The rationale for the development of the “failure to prevent” model of corporate liability in both contexts is said to be that it incentivises organisations to take reasonable steps, and put in place adequate procedures, to

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<sup>175</sup> See, for example, Value Added Tax Act 1994, s.72; Taxes Management Act 1970, s.106A or ss.106B to 106H as inserted by Finance Act 2016, s.166.

<sup>176</sup> Finance Act 2000, s.144.

<sup>177</sup> See, for example, Value Added Tax Act 1994, s.72 and the Taxes Management Act 1970, s.106A, which make it an offence to dishonestly “take steps with a view to” or be “knowingly concerned in” the evasion.

<sup>178</sup> HMRC, “Tackling tax evasion: Government guidance for the corporate offence of failure to prevent the criminal facilitation of tax evasion”, Draft Government Guidance, Oct. 2016; Criminal Finance Act 2017, ss.45(4) and 45(5).

<sup>179</sup> HMRC, “Code of Practice 9, HM Revenue and Customs investigations where we suspect tax fraud”, June 2014.

<sup>180</sup> Finance Bill 2016, s.162 and Sch.20. Penalties can be incurred of up to 100% of the tax they helped to evade or £3,000, whichever is the highest.

<sup>181</sup> Bribery Act 2010, s.7.

<sup>182</sup> Bribery Act 2007, ss. 7(1)(a) and (b).

promote corporate good governance.<sup>183</sup> Thus, mirroring the approach taken in the Bribery Act,<sup>184</sup> a due diligence defence is available to corporations who have taken reasonable steps to prevent the facilitation of tax evasion by their associates.<sup>185</sup> Whether or not the steps taken were reasonable will be a question of fact to be determined on a case-by-case basis.

## **RELATIVE INEFFECTIVENESS OF LAW IN COMBATTING FRAUD IN A FINANCIAL SERVICES CONTEXT**

In contrast to the relative effectiveness of the “failure to prevent” model in addressing bribery at a corporate level in the context of the Bribery Act 2010, the experience of the law in tackling fraud at a corporate level has been disappointing despite the considerable efforts that have devoted to this in terms of financial services regulation and the generality of the reforms made by the Fraud Act 2006. Whereas it has been seen that there is cause for optimism that levels of bribery might be falling, fraud appears to be on the increase, and the estimates fail to include issues that might potentially involve fraud, such as off-balance sheet finance and mis-selling of financial services products, because of how these have been addressed. This section seeks to analyse why the law on fraud has been relatively ineffective.

### **Inadequacy of civil law**

Much of the argument for the reform of the law on bribery turned on the inadequacy of the civil law to address the problem and, in particular, the obstacles that deterred individual claimants from pursuing a remedy in tort. Civil law has likewise proven ineffective in redressing corporate fraud, indeed that it not its purpose. The purpose of civil law is quintessentially to provide a fair outcome between the parties, typically involving compensation for loss; it is not to stigmatize or deter conduct and does not take into account the wider impact of conduct beyond the parties themselves. To evaluate its efficacy potentially requires consideration of a number of areas of law,<sup>186</sup> but principally the tort of deceit,<sup>187</sup> which is the closest that English tort law comes to a claim in fraud; and a claim for fraudulent misrepresentation in contract law, since victims of fraud, unlike victims of bribery, are frequently involved in a contractual relationship with the perpetrator. A claim for deceit is difficult. First, the claimant not only has to shoulder the burden of proof but that evidential burden is high since causing loss is central to any claim.<sup>188</sup> Second, the claimant would need to quantify the loss sustained in financial terms. Third, the claimant making a civil claim must also prove that the defendant knew that the representation was false, did not believe it was true or was reckless as to whether it was true or not.<sup>189</sup> The most problematic of these is likely to involve quantifying the loss, though losses from fraud may in some circumstances be easier to calculate than those flowing from the loss of a contract due to bribery. In

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<sup>183</sup> HMRC “Tackling offshore tax evasion: a new corporate criminal offence of failure to prevent the facilitation of evasion”, (Consultation document, 16 July 2015), paras.2.17 and 2.18, p.10.

<sup>184</sup> Bribery Act 2010, s.7(2).

<sup>185</sup> Criminal Finance Act 2017, s.45(2).

<sup>186</sup> P. McGrath, *Commercial Fraud and Civil Practice* (Oxford University Press, 2008) p.3.

<sup>187</sup> *Leni Gas and Oil Investments Ltd v Malta Oil Pty Ltd* [2014] E.W.H.C. 893.

<sup>188</sup> P. McGrath, *Commercial Fraud and Civil Practice* (Oxford University Press, 2008) p.3.

<sup>189</sup> *Derry v Peek* (1889) 14 App. Cas. 337.



contrast, since the enactment of the Fraud Act 2006, the criminal law has deliberately avoided the need for proof of a consequential effect, drafting the offence in inchoate terms and premising liability on the dishonest intention of the defendant rather than the practical effect on the victim.<sup>190</sup> A contractual claim based on misrepresentation may be made where the victim was induced to enter into the contract as a result. If the misrepresentation is fraudulent (or indeed negligent), the contract is vitiated and the claimant may claim both rescission and damages.<sup>191</sup> Again, the victim would need to finance any legal action and bears the burden of proof. In the case of small value frauds (or indeed negligent acts or omissions), often perpetrated in high quantity against numerous victims, the cost and time involved in bringing an individual claim are likely to be disproportionately high and, even if successful, is likely to outweigh any perceived benefit by way of award of damages and costs even if successful.<sup>192</sup> It is possible that much of the financial misconduct that has come to light over the past couple of decades, involving the so-called mis-selling type, has taken place under such circumstances. Ultimately, however, the tort of deceit and rescission/ damages for fraudulent misrepresentation still fail to capture the potentially vast but incalculable collateral damage that may be caused indirectly to the market by fraud and in economic terms it is this need to minimise this social harm that justifies the use of the criminal law instead.

### **Ad hoc and fragmented criminal law response to fraud**

Fraud is different to bribery and most other offences in that it is not a criminal activity in itself but the way in which an otherwise lawful activity is performed; it is therefore potentially very broad in its scope. Its distinct nature poses unique problems in addressing it.<sup>193</sup> Bribery is specific conduct that is capable of being narrowly defined and its legal evolution is characteristic of the criminal law's historic tendency to draft in the form of numerous highly-particularised offences.<sup>194</sup> Perhaps surprisingly, there was no general and overarching fraud offence until the Fraud Act 2006 came into force on 15<sup>th</sup> January 2007. Instead, there was a patchwork quilt of specialist branches of law, such as company law and financial services law, which were substantially intended to address issues of scandal and fraud,<sup>195</sup> and a few specific offences of more general application, for example, the deception-

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<sup>190</sup> The Fraud Act 2006 repealed a number of deception offences contained in the Theft Acts of 1968 and 1978, effectively making fraud a "conduct" crime as opposed to a "result" crime.

<sup>191</sup> Misrepresentation Act 1967, s.2(1).

<sup>192</sup> An example of the problems of large scale group actions generally can be seen in relation to the litigation over a Royal Bank of Scotland rights issue, where investors claimed compensation under s. 90 Financial Services and Markets Act 2000, see LexisNexis Guest Blogger "Another skirmish over privilege in the RBS Rights Issue Litigation" <http://blogs.lexisnexis.co.uk/dr/another-skirmish-over-privilege-in-the-rbs-rights-issue-litigation/> [Accessed June 6, 2017] and M. Walters "News focus: Funders helped the RBS fight" Law Society Gazette 5<sup>th</sup> June 2017.

<sup>193</sup> See below "Failure to prevent" inappropriate where corporate rather than individual dishonesty".

<sup>194</sup> See "The Historical Development of the "Failure to Prevent" Model of Organisational Liability for Bribery" above.

<sup>195</sup> For example, much early companies' legislation, notably the Joint Stock Companies Act 1844, was a response to often quite crude forms of fraud and may actually have worsened the problem, see S.F. Copp, "Limited Liability and Freedom", Ch. 8 in S.F. Copp (ed.) "The Legal Foundations of Free Markets" (London: Institute of Economic Affairs, 2008) at 173.



type offences under the Theft Acts 1968 and 1978.<sup>196</sup> The Fraud Act 2006 replaced most of the specific offences that pre-dated it, but left company law and financial services law – and their voluminous and complex regulatory architecture,<sup>197</sup> essentially untouched. This included a raft of highly particularised criminal offences and specialist regulatory agencies armed with enforcement powers,<sup>198</sup> such as the FCA and PRA who now regulate the financial and banking sectors. Consequently, the Fraud Act 2006 did not bring about the sea-change in the law’s response to fraud that the Bribery Act 2010 has brought to bribery. Most obviously, it did not contain a bespoke model to deal with corporate fraud and left the attribution of liability subject to the pre-existing but problematic common law identification principle. It also left in its wake a perception that regulatory issues were somehow a lesser and separate category from fraud which might be perceived as “real crime” and a question mark over whether conduct in a regulated industry, such as financial services, should be treated as a matter of regulation or true fraud in the event of a conflict – and as to which authority, general or regulatory – should address it.

### **Financial services regulation potentially satisfies compensatory and deterrent goals**

This article has demonstrated that if mis-selling in financial services were to be seen as a matter of fraud, this would considerably increase the volume of identified fraud in the UK. The authors have made out the economic case for criminalising financial crime elsewhere.<sup>199</sup> Robust intervention – whether through regulation or generic criminal law - can be justified on the basis that this is a highly-specialized market in which consumers typically lack sophistication. Most will have little or no past knowledge or experience to inform their decision-making and will rely instead on the information disseminated by the product or service provider within the confines of a relationship in which the consumer has scant bargaining power. In economic terms, they experience judgment problems that may justify state intervention;<sup>200</sup> the imbalance in knowledge, information asymmetry, gives rise to a risk that the provider provides false or misleading information.<sup>201</sup> Regulation is justified in such circumstances to deter the systematic production of misinformation, to avoid the making of

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<sup>196</sup> Examples include Theft Act 1968, s.15 obtaining property by deception; s.16 obtaining a pecuniary advantage by deception; Theft Act 1978, s.1 obtaining services by deception.

<sup>197</sup> See, for example, S. Copp and A. Cronin, “The failure of criminal law to control the use of off balance sheet finance during the banking crisis” (2015) 36 *Company Lawyer* (4) 99, esp. 100 – 101. [though significantly the abuse of power provisions of the Fraud Act served to criminalise the hitherto largely civil regime of directors’ duties despite the preceding Law Commissions and Modern Company Law Review rejecting such an approach.]

<sup>198</sup> Law Commission, *Criminal Liability in Regulatory Contexts* (2002), paras.1.9 and 1.21.

<sup>199</sup> S.F. Copp and A. Cronin, “The Failure of Criminal Law to Control the Use of Off Balance Sheet Finance During the Banking Crisis” (2015) 36(4) *Company Lawyer* 99. See too G.S. Becker, “Crime and Punishment: An Economic Approach” (1968) 76 *Journal of Political Economy* 169; K.G. Elzinga and W. Breit, *The Anti-trust Penalties: a Study in Law and Economics* (Yale University Press, 1976); J.C. Coffee, “Corporate Crime and Punishment: A Non-Chicago View of the Economics of Criminal Sanctions”, (1980) 17 *American Criminal Law Review* 419-76; R.A. Posner, “An Economic Theory of the Criminal Law” (1985) 85 *Columbia Law Review* 1193-231; K.G. Dau-Schmidt, “An Economic Analysis of the Criminal Law as a Preference-Shaping Policy” (1990) *Duke Law Journal* 1 - 38, P. O’ Malley, “Risk, Power and Crime Prevention” (1992) 21 *Economy and Society* 252; Richard A Posner, *Economic Analysis of Law* (Aspen, 2007).

<sup>200</sup> See generally B.R. Cheffins, “Company Law, Theory, Structure, Operation” (Oxford: Oxford University Press, 1997), 134 – 138.

<sup>201</sup> B.R. Cheffins, “Company Law, Theory, Structure, Operation” (Oxford: Oxford University Press, 1997), p.129.

socially wasteful investments; and to discourage transactions that fail to allocate resources efficiently.<sup>202</sup> In addition to such problems of an economic nature, many financial products have a relatively long duration such that problems are likely only to manifest long after the initial enquiry and purchase stage of the contract, albeit with potentially drastic consequences for the consumer,<sup>203</sup> which may give rise to a variety of evidential and practical problems, e.g. where there is a corporate reorganisation and the original transacting party cannot be held liable. Such issues have led to a range of consumer protection responses, of which the regulatory bodies are one.

In relation to the mis-selling scandals involving financial products and derivatives, the FCA is the empowered enforcer under the Consumer Rights Act 2015 (CRA), a qualifying body under both the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR)<sup>204</sup> and the Financial Services and Markets Act 2000.<sup>205</sup> In addition to the general law of contract, the FCA's Principles for Businesses oblige regulated firms to act fairly. Principle 1 demands that a firm conducts its business with integrity while Principle 6 requires it to "pay due regard to the interests of its customers and treat them fairly." Principle 7 requires the firm to "pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading" and Principle 9 stipulates that the firm takes reasonable care to ensure the suitability of its advice and discretionary decisions for any customer entitled to rely on its judgement. In practice, it is this principle-based approach to regulation that has provided the gateway for consumer redress in relation to mis-selling<sup>206</sup> as this is far less susceptible to circumvention by contract law and complex legal processes which have been used to challenge the firms' application of highly detailed and technical rules.<sup>207</sup> The consumer receives redress in the form of compensation while the regulated firm is fined for a regulatory breach. These Principles can be seen to seek to address issues of judgement problems and information asymmetry and combine the need for a civil law compensatory approach with the criminal law's need for deterrence and stigmatization. Whether these later goals are adequately served by these mechanisms is evaluated further below.

### **Insufficient stigma/ deterrence with regulatory enforcement**

By virtue of its distinct history and genealogy, bribery has been subject to different institutional enforcement and procedures than other economic misconduct committed in the

<sup>202</sup> B.R. Cheffins, "Company Law, Theory, Structure, Operation" (Oxford: Oxford University Press, 1997), p.129.

<sup>203</sup> European Parliament, Directorate General For International Policies, Policy Department A: Economic and Scientific Policy, Consumer Protection Aspects of Financial Services, 2014.

<sup>204</sup> In co-ordination with the Competition and Markets Authority which has a leadership role enforcing both, see <https://www.fca.org.uk/firms/unfair-contract-terms> [Accessed May 22, 2017]. The Unfair Terms in Consumer Contracts Regulations 1999 (U.T.C.C.R.s) implement the Unfair Terms in Consumer Contracts Directive (93/13/EC) and apply to contracts entered into from July 1, 1995 to Sept. 30, 2015. On Oct. 1, 2015 the U.T.C.C.R.s were revoked and replaced by the Consumer Rights Act 2015.

<sup>205</sup> Financial Services and Markets Act 2000.

<sup>206</sup> The FCA's powers extend beyond the protection of non-business consumers to all customers of regulated products and services.

<sup>207</sup> <http://www.govanlc.com/MissellingCC.pdf> [Accessed May 22, 2017].

commercial arena. This distinction is not the result of any considered theory or predetermined plan but essentially derives from the fact that the majority of bribery and overseas corruption cases happen to have involved the activities of companies that happen to be unregulated and therefore fall under the remit of the Serious Fraud Office (“SFO”) and the Crown Prosecution Service (“CPS”).<sup>208</sup> In contrast, the mis-selling cases that have hit the headlines to date happen to have occurred predominantly in the regulated financial sector where investigatory and enforcement powers are bestowed upon the Financial Conduct Authority (“FCA”) and the Prudential Regulation Authority (“PRA”).<sup>209</sup> Consequently, at the institutional level, bribery appears to be regarded a far more serious infringement than economic crime involving fraud; bribery has always been a crime subject to prosecution while corporate frauds, such as mis-selling, are conceived as a regulatory breach. The respective gravity of the misconduct in question has not been determined by reference to the activity itself, but by association with the particular enforcement agency and enforcement process invoked.

This position gives rise to some anomalies in practice, as is illustrated by the case of JLT Speciality Ltd. which was fined by the FCA in December 2013 for regulatory non-compliance by way of its failure to have adequate procedures in place to prevent bribery, thus breaching the FCA’s general principles.<sup>210</sup> Conceived as a compliance breach, this treatment accords with the aim of the FCA, to “make sure that financial markets work well so that consumers get a fair deal”, ensuring that “the financial industry is run with integrity”, that “firms provide consumers with appropriate products and services” and that “consumers can trust that firms have their best interests at heart”.<sup>211</sup> In different circumstances<sup>212</sup> the same failure, with the same degree of corporate “negligence”, would amount to the commission of the serious criminal offence contained in the Bribery Act 2010.<sup>213</sup>

The FCA has a wide range of enforcement powers which are regulatory, civil and criminal in nature, however, there has been arguably little in the recent past to distinguish conduct which falls short of a minor disclosure requirement and that which is tantamount to criminal fraud. For example, where a fine was imposed on a firm for mis-selling complex investments to customers, the FCA’s Upper Tribunal finding was phrased in the language of a “failure to take reasonable care to ensure that its recommendations to customers to invest [in this

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<sup>208</sup> The SFO is currently the lead agency in England and Wales for investigating (jointly with the police in some cases) and prosecuting overseas corruption. The Crown Prosecution Service also prosecutes bribery offences investigated by the police, committed overseas or in England and Wales, see [http://www.cps.gov.uk/legal/a\\_to\\_c/bribery\\_act\\_2010/#a02](http://www.cps.gov.uk/legal/a_to_c/bribery_act_2010/#a02) [Accessed May 26, 2017] and note that prosecution under the Bribery Act 2010, s.10 requires the personal consent of either the Director for Public Prosecutions or the Director of the SFO.

<sup>209</sup> <http://www.bankofengland.co.uk/prd/pages/default.aspx> [Accessed May 26, 2017]. The PRA is the regulator of banks, building societies, credit unions, insurers and designated investment firms.

<sup>210</sup> H. Laming, “Anything you can do? How bribery is being policed by the FCA as well as the SFO”, (2014) 3 *Butterworths Journal of International Banking and Finance Law* 183. The Bribery Act 2010, s.7 imposes criminal liability where an actual act of bribery occurs and it is a defence for a firm to say that it had adequate procedures in place to prevent it albeit there is no duty to have measures in place. In contrast, regulated firms are under a duty to have appropriate systems and controls in place.

<sup>211</sup> <http://www.fca.org.uk/about> [Accessed May 26, 2017].

<sup>212</sup> I.e. where an actual active bribe occurred.

<sup>213</sup> Bribery Act 2010, s.7.

product] were suitable, having regard to what it knew about those customers” where information had not been provided to the customers in a “clear and fair” way.<sup>214</sup>

The important distinction between the SFO and the regulatory agencies is one that the SFO has been at pains to emphasize in recent months. Speaking at the TRACE Global Anti-Bribery In-House Network (GAIN) Conference in October 2016, the Joint Head of Fraud, Hannah von Dadelszen announced, “We are a law enforcement agency and not a regulator ...we are not in the business of telling people how not to rob a bank ... [and] to take on an advisory role would be to assume functions which simply aren’t in our enabling legislation. We are investigators and prosecutors”.<sup>215</sup>

### **Other weaknesses in the regulatory approach**

The general efficacy of the regulatory approach to deal with “real crime” has been a matter of considerable doubt for some considerable time.<sup>216</sup> Experience of financial services regulation suggests that its role is questionable. The Parliamentary Commission on Banking Standards reported in 2013-14 that, “misconceived and poorly-targeted regulation has been a major contributory factor across the full range of banking standards failings ... (r)egulators were complicit in banks outsourcing responsibility for compliance to them by accepting narrow conformity to rules as evidence of prudent conduct”.<sup>217</sup> Although the level of FCA fines had begun to exceed those previously issued by the FSA, they decreased dramatically from the start of 2016,<sup>218</sup> after George Osborne’s Mansion House speech in 2015, expressing the

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<sup>214</sup> <http://www.fca.org.uk/news/tribunal-upholds-fca-fine-on-firm-for-misselling-complex-investments> [Accessed May 26, 2017] in relation to a decision of the Upper Tribunal on 22 Nov. 2013 about Westwood Independent Financial Planners.

<sup>215</sup> H. von Dadelszen, Joint Head of Fraud, SFO, “Gain 2016 – The Serious Fraud Office’s Current Direction and Enforcement Priorities”, Oct. 27, 2016 at <https://www.sfo.gov.uk/2016/10/27/gain-2016-serious-fraud-offices-current-direction-enforcement-priorities/> [Accessed May 26, 2017].

<sup>216</sup> See for example J. Gobert and M. Punch, *Rethinking Corporate Crime* (Butterworths 2003); M. Levi, *Regulating Fraud* (Tavistock, 1987); M. Levi, *The Economic Cost of Fraud Report for the Home Office* (London, NERA 2000); M. Levi, “The Roskill Fraud Commission Revisited: An Assessment” (2003) *Journal of Financial Crime* 11(1), 38-44; Michael Levi, *The Phantom Capitalists* (Ashgate, 2008); Levi Michael et al, *The Nature, Extent and Economic Impact of Fraud in the UK* (London: ACPO, 2007); The Royal Commission on Criminal Justice *The Investigation, Prosecution and the Trial of Serious Fraud*: (London: HMSO, 1993); J.E. Parkinson, *Corporate Power and Responsibility, Issues in the Theory of Company Law* (Clarendon, 2000); D. Sugarman, “Law Economy and the State in England 1750-1914: Some Major Issues” in D. Sugarman (ed.) *Legality, Ideology and the State* (Academic Press 1983); Edward S Herman, *Corporate Control, Corporate Power* (Cambridge University Press, 1981); G. Slapper and S. Tombs, *Corporate Crime* (Longman, 1999); G.P. Gilligan, “The Origins of UK Financial Services Regulation”, (1997) 18(6) *Company Lawyer* 167-176; S.P. Shapiro, “Collaring the Crime, Not the Criminal: Reconsidering the Concept of White Collar Crime” (1990) 55 *American Sociological Review* 346-65; G. Scanlan, “Dishonesty in Corporate Offences, A Need for Reform?” (2002) 23(4) *Company Lawyer* 114-119; G. Scanlan, “Offences concerning directors and officers of a company – fraud and corruption in the United Kingdom – the future” (2008) 29(9) *Company Lawyer* 264 – 271; J.L. Masters, “Fraud and Money Laundering: the evolving criminalization of corporate non-compliance” (2008) *Journal of Money Laundering Control* 103.

<sup>217</sup> Parliamentary Commission on Banking Standards, “Changing banking for good, First Report of Session 2013-14”, Vol.1, p.18, para. 21.

<sup>218</sup> The increase in level of fines was partly driven by the action taken for LIBOR and FX market manipulation and a significant increase in the level of fines for other breaches from just below £1million in 2008 to £24million in 2015, see New City Agenda and Cass Business School, New City Agenda and Cass Business School,

concern that ratcheting up ever-larger fines simply penalises shareholders, erodes capital reserves and diminishes the lending potential of the economy.<sup>219</sup> In their October 2016 Report, the financial services think-tank, New City Agenda, and Cass Business School identified the limitations of ever more detailed regulation and that policy-makers need to acknowledge and work to remove the culture of secrecy that has developed within regulatory agencies.<sup>220</sup> It noted particularly that the FCA still lacks independence, continuing to be susceptible to pressure from both politicians and industry.<sup>221</sup> In economic terms, this poses the risk that it might be subject to regulatory capture.<sup>222</sup> Furthermore, the compliance costs now amount to a significant barrier to entry, the FCA and PRA rulebooks, guidance and supervisory statements, together comprising a staggering quantity of information exceeding 13,000 pages.<sup>223</sup> Similarly, the cost of compliance must be added to the operating costs of the regulators themselves, the total administrative costs of the FCA, PRA, Financial Ombudsman Service, Financial Services Compensation Scheme and Money Advice Service alone now reaching almost £1.2 billion a year, a six fold increase since 2000.<sup>224</sup>

### **Deference to the regulatory regime where fraud is concerned**

The regulatory regime is considered quasi-criminal in nature in that it typically employs a mixture of civil sanctions to encourage compliance, backed up by criminal provisions for breach. Regulations tend to be drafted as “strict liability” which means that no blameworthy mental state is required to accompany one or more of the physical elements amounting to the breach. This approach neatly side-steps the criminal law’s problem of attribution and proving of corporate *mens rea*. Further, the quasi-moral view of crime, requiring blameworthiness on the part of the defendant, is typically met with the availability of a due diligence defence.<sup>225</sup> This reverse onus defence allows the offence to be treated as if it were a *mens rea* offence in that the defendant is permitted to prove, on the balance of probabilities, that all reasonable

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“Cultural Change in the FCA, PRA and Bank of England, Practising What They Preach?”, 25 October 2016 at [http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report\\_embargoed.pdf](http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report_embargoed.pdf) [Accessed May 21, 2017], p.73.

<sup>219</sup> <https://www.gov.uk/government/speeches/mansion-house-2015-speech-by-the-chancellor-of-the-exchequer> [Accessed May 26, 2017].

<sup>220</sup> New City Agenda and Cass Business School, “Cultural Change in the FCA, PRA and Bank of England, Practising What They Preach?”, 25 October 2016 at [http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report\\_embargoed.pdf](http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report_embargoed.pdf) [Accessed May 21, 2017].

<sup>221</sup> Ibid.

<sup>222</sup> See further C. Veljanovski, “The Economics of Law” (London: Institute of Economic Affairs, 2006), p. 149.

<sup>223</sup> New City Agenda and Cass Business School, New City Agenda and Cass Business School, “Cultural Change in the FCA, PRA and Bank of England, Practising What They Preach?”, 25 October 2016 at [http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report\\_embargoed.pdf](http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report_embargoed.pdf) [Accessed May 21, 2017], p.38.

<sup>224</sup> New City Agenda and Cass Business School, New City Agenda and Cass Business School, “Cultural Change in the FCA, PRA and Bank of England, Practising What They Preach?”, 25 October 2016 at [http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report\\_embargoed.pdf](http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report_embargoed.pdf) [Accessed May 21, 2017], p.58.

<sup>225</sup> Law Commission, *Criminal Liability in Regulatory Contexts* (2002), Part 6.

precautions had been taken to avoid the harm in question.<sup>226</sup> Although largely unsuccessful, the preference for regulatory enforcement over criminal prosecution has precluded the use of the stronger tool in cases of serious corporate fraud. Consequently perhaps, scant attention has been given to the problem of attribution in the criminal law and there has been little motivation to develop a principle of corporate liability for fraud. There is some economic justification for the regulatory approach by analogy with the debate over the use of *ex ante* or *ex post* legal responses to safety regulation.<sup>227</sup> In the context of fraud there is much to be said for seeking to address issues *ex ante* where there are issues of judgement problems that may affect access to a remedy and the magnitude of potential claims could put in jeopardy the ability of the perpetrator to pay. However, where serious criminal offences are combined with a due diligence regime with recognised standards it might be possible to realise the benefit of both the *ex ante* and *ex post* approaches.

The architects of the Fraud Act 2006 clearly envisaged corporate prosecutions for fraud;<sup>228</sup> however, the reality has not met expectations. Following an earlier consultation between the regulator and the regulated in the context of misleading market practices, the Law Commission had already dismissed prosecutions of this nature in the corporate context, deferring instead to the regulatory regime. Specifically, it stated that, “many other offences which can be described as frauds”<sup>229</sup> are “usually seen as specialist branches of fraud, which require separate consideration”.<sup>230</sup> This response accorded with the recommendation made 2 decades earlier by the Royal Commission which had confined the activity of the CPS to prosecutions for what was considered mainstream crime.<sup>231</sup> Initial optimism that the Fraud Act would provide an important new weapon in the fight against major financial crime was therefore misplaced; although the Act has been in force for 10 years, prosecutions for corporate frauds are rarely brought before the criminal courts and the response continues to hover somewhere between civil sanction for regulatory breach and civil private action. Excluded from mainstream prosecution, systemic fraud committed in the corporate context has therefore continued to attract a different moral compass.<sup>232</sup>

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<sup>226</sup> Law Commission, *Criminal Liability in Regulatory Contexts* (2002), para.6.25 and see too C. Wells, “Corporations and Criminal Responsibility” (Oxford University Press, 2001) pp.101 - 102.

<sup>227</sup> See generally C. Veljanovski, “The Economics of Law” (London: Institute of Economic Affairs, 2006), p. 157.

<sup>228</sup> Fraud Act 2006, s.12 implicitly provides that company officers may be liable for fraud as individuals where they have consented or connived with the fraud of the body corporate.

<sup>229</sup> Law Commission, *Report on Fraud* (2002), para.2.26, p.11.

<sup>230</sup> Law Commission, *Report on Fraud* (2002), para.2.27, p.12. The explanation given was that the decision to keep “specialist branches of fraud” separate followed consultation between regulator and regulated in the context of misleading market practices to help draw the line between sharp practice and criminal practice.

<sup>231</sup> Royal Commission on Criminal Procedure (*The Phillips Commission*) 1977, reported in 1981, “The Investigation and Prosecution of Criminal Offences in England and Wales: the law and procedure” (1980/81 Cmnd. 8092-I and II).

<sup>232</sup> Of note, when the Royal Commission provided the recommendations that formed the basis of the new Crown Prosecution Service in 1981, the ambit of the report was confined to mainstream crime; Royal Commission on Criminal Procedure (*The Phillips Commission*) 1977, reported in 1981, *The Investigation and Prosecution of Criminal Offences in England and Wales: the law and procedure* (Cmnd. 8092-I and II, 1980/81). The Commission gave little attention to the non-police agencies, commenting that “prosecution is the weapon of final resort because they prefer to obtain their objectives by education and persuasion”.

## Need for greater stigmatization

The extent of financial misconduct witnessed in the last few decades, whether money-laundering, fraud or bribery, demonstrates a strong case for the intervention of the criminal law. Inadequate consumer protection in the financial services sector, consequent upon the inadequacy of regulatory regimes, has been specifically identified as a major contributor to the global financial crisis of 2007/2008.<sup>233</sup> At EU level, the mis-selling of financial products has resulted in significant consumer harm to the general detriment of market efficiency.<sup>234</sup> This is reflected in the UK's Fair and Effective Markets Review of 2015 containing recommendations to deliver "fair" markets, these being defined as "markets in which participants behave with integrity ... [and] that means participants should be confident that they will not be subject to fraud, deception, disinformation, misrepresentation, manipulation or coercion."<sup>235</sup> Without doubt, public trust has been damaged by numerous and extensive the mis-selling scandals that have been reported in recent years.<sup>236</sup> The much criticized so-called "light touch" approach that became synonymous with regulation in the financial sector has given way to widely articulated calls for a more robust regime.<sup>237</sup> Accordingly, measures are now underway to implement the Fair and Effective Markets initiatives<sup>238</sup> within the industry<sup>239</sup> as a means to ensure both individual and collective accountability for corporate misconduct, accompanied by financial disincentives and the call for tougher regulatory and criminal punishments.<sup>240</sup>

The inherent nature of the corporate misconduct involved in fraudulent types of behaviours also demands its stigmatization as criminal activity, aside from the extent of the harm caused to individuals and to markets. This point was specifically argued in the context of the bribery

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<sup>233</sup> European Parliament, Directorate General For International Policies, Policy Department A: Economic and Scientific Policy, Consumer Protection Aspects of Financial Services, 2014.

<sup>234</sup> European Parliament, Directorate General For International Policies, Policy Department A: Economic and Scientific Policy, Consumer Protection Aspects of Financial Services, 2014.

<sup>235</sup> HM Treasury, Bank of England, Financial Conduct Authority, "Fair and Effective Markets Review, Final Report, 2015", para.1.1.

<sup>236</sup> New City Agenda and Cass Business School, New City Agenda and Cass Business School, "Cultural Change in the FCA, PRA and Bank of England, Practising What They Preach?", 25 October 2016 at [http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report\\_embargoed.pdf](http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report_embargoed.pdf) [Accessed May 21, 2017], p.13.

<sup>237</sup> See e.g. Parliamentary Commission on Banking Standards, "Changing Banking for good", June 12, 2013; HM Treasury, Bank of England and FCA, "Fair and Effective Markets Review, Final Report" 2015, which analyses the root causes of recent misconduct in the fixed income, currency and commodities markets; New City Agenda and Cass Business School, New City Agenda and Cass Business School, "Cultural Change in the FCA, PRA and Bank of England, Practising What They Preach?", 25 October 2016 at [http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report\\_embargoed.pdf](http://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-change-in-regulators-report_embargoed.pdf) [Accessed May 21, 2017].

<sup>238</sup> The Fair and Effective Markets Review: Implementation Report is available at <http://www.bankofengland.co.uk/markets/Documents/femr/implementationreport.pdf> [Accessed May 26, 2017].

<sup>239</sup> The call for cultural change to transform regulation has been put into effect by the Bank of England and the Prudential Regulation Authority in the "One Bank, One Mission" programme, see details provided at <http://www.bankofengland.co.uk/about/Pages/strategicplan/default.aspx> [Accessed May 26, 2017].

<sup>240</sup> The Fair and Effective Markets Review: Implementation Report at <http://www.bankofengland.co.uk/markets/Documents/femr/implementationreport.pdf> [Accessed May 26, 2017].



reform and, in its review of criminal liability in regulatory contexts, the Law Commission also proposed that criminal law should be employed where the stigma of conviction is deserved. This is identified in instances where the wrongdoer has engaged in seriously reprehensible conduct<sup>241</sup> and the harm done or risked should be regarded as serious enough to warrant criminalization if, in some circumstances, an individual could justifiably be sent to prison for a first offence, or an unlimited fine is necessary to address the seriousness of the wrongdoing.<sup>242</sup> Furthermore, serious offences are those involving dishonesty, intention, knowledge or recklessness<sup>243</sup> and the Law Commission specifically contemplated the fraud based offences<sup>244</sup> where the harm relates a moral failing and not just to a breach of a rule or a departure from a standard.<sup>245</sup>

### Need for a corporate sanction

There is a risk that the punitive aim has simply shifted the focus onto the particular *individuals* behind fraudulent market manipulation and financial crime, through measures for improved accountability at senior management level.<sup>246</sup> However, although individual accountability is certainly to the fore,<sup>247</sup> it is of note that the Bribery Act 2010 has taken a robust approach to *corporate* prosecution, doing so on the basis of the harm inflicted on economic markets<sup>248</sup> and that these measures form part of a larger picture which includes a renewed commitment to extend *corporate* responsibility and, in particular, the “failure to prevent” construction of liability to other economic crimes<sup>249</sup> such as fraud. In cases which merit the attachment of a serious stigma, such as potentially wide-spread mis-selling cases, it is appropriate that the stigma attaches to the corporate actor responsible to as to secure maximum deterrence.

<sup>241</sup> Law Commission, “Criminal Liability in Regulatory Contexts” (2010), p.8, para.1.28.

<sup>242</sup> Law Commission, “Criminal Liability in Regulatory Contexts” (2010), p.8, para.1.29.

<sup>243</sup> Law Commission, “Criminal Liability in Regulatory Contexts” (2010), p.28, para.3.10.

<sup>244</sup> Law Commission, “Criminal Liability in Regulatory Contexts” (2010), p.11, para. .42.

<sup>245</sup> Law Commission, “Criminal Liability in Regulatory Contexts” (2010), p.68, para.4.2.

<sup>246</sup> <https://www.gov.uk/government/speeches/mansion-house-2015-speech-by-the-chancellor-of-the-exchequer> [Accessed May 26, 2017].

<sup>247</sup> See e.g. HM Treasury, Bank of England and FCA, “Fair and Effective Markets Review, Final Report 2015” key principles 1 and 3, policy recommendation 1 and the Senior Manager and Certification Regimes; Parliamentary Commission on Banking Standards, First Report of Session 2013-14, Changing banking for good, Vol. I, June 12, 2013.

<sup>248</sup> Law Commission, *Reforming Bribery* (2008) App. D, para.D.5 and citing P. W. Alldridge, “The Law Relating to Free Lunches” (2002) 23 *Company Lawyer* 264, 267. Another example is the approach taken to address money laundering in the Proceeds of Crime Act 2002, s.330. Ministry of Justice, “Impact Assessment of the Bill on Reform of the Law of Bribery”, at <https://www.justice.gov.uk/downloads/legislation/bills-acts/bribery-bill-ia.pdf> [Accessed May 22, 2017]. See the Bribery Act 2010, which takes a zero-tolerance approach to corporate corruption; The Secretary of State for Justice, then Jack Straw, when addressing the 5<sup>th</sup> European Forum on Anti-corruption in June 2009, “A strong legal architecture is necessary in tackling corruption ...Ultimately our aim must be to bring about behavioural change within businesses themselves, creating corporate cultures in which no form of corruption is tolerated”.

<sup>249</sup> See e.g. the speech of David Green, CB, QC, Director of the Serious Fraud Office at the 2016 Cambridge Economic Crime Symposium at <https://www.sfo.gov.uk/2016/09/05/cambridge-symposium-2016/> [Accessed May 27, 2017]; the speech of Jeremy Wright, Attorney General, at the same event, <https://www.gov.uk/government/speeches/attorney-general-jeremy-wright-speech-to-the-cambridge-symposium-on-economic-crime> [Accessed May 27, 2017].



## THE APPROPRIATENESS OF THE “FAILURE TO PREVENT” MODEL TO “ECONOMIC CRIME”, SPECIFICALLY FRAUD IN A FINANCIAL SERVICES CONTEXT

While the need to bring corporate economic crime within the mainstream criminal law is becoming increasingly evident, the suggestion of a new corporate economic offence premised on the “failure to prevent” model of liability would provide only limited redress, based on an overly narrow and myopic conceptualisation of the problem. Although the “failure to prevent” construction has achieved much needed theoretical advancements to the criminal law’s response to corporate wrongdoing, a generic “one size fits all” model of corporate criminality simply cannot accommodate the very different underlying bases of very different substantive offences. Supplementing the common law’s identification doctrine, which facilitates a corporate conviction for bribery based on the culpability of its “directing mind and will”, the corporate “failure to prevent” offence provides the means by which a company can now be made liable in relation to this activity at the lower, “rogue” employee, level. The “failure to prevent” model implicitly recognizes and treats the corporate body as a responsibility-bearing actor, distinct from its individual members. This aspect accords with the now widely recognised holist view of the organisation, such that it can become an autonomous actor whose behaviour “transcends specific individual contributions”<sup>250</sup> and whose personality is unique.<sup>251</sup> However, in that the corporate liability can only be imposed where a rogue employee or associated person has committed an underlying offence, the Bribery Act 2010 conforms to the traditional individualist paradigm that continues to pervade the criminal law. Accordingly, the corporate conviction for the “failure to prevent” an underlying offence is, like the identification doctrine, parasitic in nature.

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<sup>250</sup> P.A. French, “The Corporation as a Moral Person” (1979) 16 *American Philosophical Quarterly* 207, 211 and P.A. French, *Collective and Corporate Responsibility* (Columbia University Press 1984); C. Wells, *Corporations and Criminal Responsibility* (Oxford: Oxford University Press, 2001) ch.4; J. Gobert and M. Punch, *Rethinking Corporate Crime* (Butterworths, 2003); C. Harding, *Criminal Enterprise: Individuals, Organisations and Criminal Responsibility* (Willan, 2007) 226, 227; P.N. Pettit, “Responsibility Incorporated” (2007) 117 *Ethics* 171, 172; Law Commission, *Criminal Liability in Regulatory Contexts* (2010) App. C, para C.26 – C.28. This view is similar to acceptance of the state as an organisational actor in its own right in international law, see too R. Scruton, “Corporate Persons” (1989) *Proceedings of the Aristotelian Society (supplementary series)* 239; J.A. Quaid, “The Assessment of Corporate Criminal Liability on the Basis of Corporate Identity: An Analysis” (1998) 423 *McGill LJ* 67, 78; C. Wells and J. Elias, “Catching the Conscience of the King: Corporate Players on the International Stage” in P. Alston (ed.), *Non State Actors and Human Rights* (Oxford University Press, 2005) 155; Hegel, *The Philosophy of Right* (trans. T.M. Knox, Oxford University Press, 2010) pp.279-283.

<sup>251</sup> J. Clough, “Bridging the Theoretical Gap: The Search for a Realist Model of Corporate Criminal Liability” (2007) 18 *Criminal Law Forum* 267, 275 – 76. Clough states that the personality arises from various identifiable characteristics which include the corporate structure, goals, training provisions, compliance systems, reactions to past violations, incentives and remedial steps, “(t)hese are all matters which are under the control of those who manage the organisation”; in French’s language the “conglomerate” replaces the “aggregate” collective actor, suggesting that the attribution of agency applies to the former but not the latter since the conglomerate group actor is defined as being more than a sum of its parts, P.A. French, “The Corporation as a Moral Person”, (1979) 16 *American Philosophical Quarterly* 207 reprinted as ch.9 in L. May and S. Hoffman (eds.), *Collective Responsibility, Group Based Harm and Corporate Rights* (University of Notre Dame Press, 1987) discussed by C. Harding, *Criminal Enterprise: Individuals, Organisations and Criminal Responsibility* (Willan, 2007) ch.9; P.H. Bucy, “Corporate Ethos: A Standard for Imposing Corporate Criminal Liability” (1991) 75 *Minnesota Law Review* 1095, 1124; B. Fisse and J. Braithwaite, *Corporations, Crime and Accountability* (Cambridge University Press, 1993).

## **“Failure to prevent” inappropriate where corporate rather than individual dishonesty**

The parasitic approach to organisational fault may be well suited to dealing with conduct such as bribery and tax evasion but it is of limited application to criminal fraud which, by its nature, poses unique challenges.<sup>252</sup> Unlike bribery, fraud is not an activity in itself but the way in which an otherwise lawful activity is performed.<sup>253</sup> Whereas the inducement of the improper performance of a function or activity, subject to a test of what a reasonable person would expect, underpins bribery,<sup>254</sup> dishonesty is the determinative characteristic of fraud and it is this hallmark that distinguishes lawful from criminal behaviour.<sup>255</sup> Thus, while corporate liability for bribery or tax evasion can flow from the substantive crime having been committed by the individual employee or associate,<sup>256</sup> corporate fraud will not always attach to an underlying offence committed by an individual. Although there will be instances in which it will be established that the guilt of a directing mind can be attributed to the company through the common law principle and also instances where a “rogue” employee has acted fraudulently, with the requisite dishonesty, there will be others in which individual culpability may not arise. For example, the recent mis-selling scandals point more readily to the existence of a criminogenic corporate culture in which dishonesty cannot necessarily be located either in individual directors or in the potentially numerous individual employees involved in the sales practice. If the particular activity, here the “mis-selling”, is deemed dishonest, the dishonest culture may well have emerged as a result of various divergent factors such as corporate and individual sales targets, sales policies and risk aversion strategies, all or some of which at some point overlapping and ultimately culminating in the reprehensible conduct itself. In such circumstances it is entirely conceivable that the honesty of individual employees who have been engaged in the practice will not be in doubt, for example where the product sold was one of a range offered by the organisation and the selling of it was an encouraged or essential part of the individual’s contract of employment, consistent with company policy and part of a company-wide, and perhaps industry-wide, practice.<sup>257</sup> Accordingly, the attribution of corporate liability for an economic crime which is parasitic in nature, such as fraud, cannot work where the individuals involved in the conduct cannot be said to be dishonest and have therefore not committed any underlying offence.

Thus, in the context of corporate fraud, the “identification principle” and the “failure to prevent” approaches can deal with some forms of offending, but not all. Similarly, where the physical elements of the conduct in question are performed by subordinate employees who

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<sup>252</sup> A. Cronin, “Reforming Corporate Fraud Regulation in the UK: A Model of Manifest Liability”, PhD thesis, Bournemouth University (Taylor Francis, 2017, forthcoming) *sub nom* “*Corporate Criminality and Liability for Fraud*”.

<sup>253</sup> P. McGrath, *Commercial Fraud and Civil Practice* (Oxford University Press, 2008) 3.

<sup>254</sup> Bribery Act 2010, ss.4 and 5.

<sup>255</sup> S.F. Copp and A. Cronin, “The Failure of Criminal Law to Control the use of Off Balance Sheet Finance During the Banking Crisis” (2015) 36(4) *Company Lawyer* 99.

<sup>256</sup> Albeit that the individual does not necessarily need to be prosecuted or convicted.

<sup>257</sup> A. Cronin, “Reforming Corporate Fraud Regulation in the UK: A Model of Manifest Liability”, PhD thesis, Bournemouth University (Taylor Francis, 2017, forthcoming) *sub nom* “*Corporate Criminality and Liability for Fraud*”.

are probably not dishonest, it is unlikely that they will be viewed as accessories to the offence since this would require an intention to assist or belief that their actions are capable of doing so. In such circumstances, the criminal law may invoke the doctrine of innocent agent,<sup>258</sup> whereby the individuals performing the *actus reus* of the crime possess no blameworthy state of mind with the result that criminal liability rests entirely with the person who instigates the conduct, assuming that this person has the necessary *mens rea* to make out the offence. However, this analysis is equally problematic in that it inevitably leads to the perennial challenge posed by the requirement of *mens rea* and, bearing in mind the deficiencies in the identification doctrine, how the necessary dishonesty and intention might be attributed to the corporate actor.

### **“Failure to prevent” inappropriate where the parties to criminal activity may include the company itself**

There are further serious differences in the inherent nature of money-laundering, fraud, tax evasion and bribery which mean that the “failure to prevent” model of fault attribution may be much less effective. For example, the parties involved in bribery and tax evasion are fairly clear, whereas with fraud the victim may not only be third parties, such as the public, but the company itself. Such a consequence would render the imposition of corporate liability for “failure to prevent” uncomfortable at an intuitive level and controversial, as was the case in *Moore v Bresler Ltd* [1944],<sup>259</sup> the Divisional court finding that the corporate defendant was both the victim and the perpetrator of the fraud.

## **CRIMINALISING THE CORPORATION: PROPOSALS FOR REFORM**

The primary mechanism for attributing corporate criminal liability continues to be the common law identification doctrine which operates for both common law and statutory offences but is, of course, strictly limited by the need to find that the substantive offence has been committed by an individual who represents the controlling or directing mind of the organisation. This works well in instances where, for example, the owner/director of a small company commits an offence using the corporate form as the vehicle to do so. In cases involving a “rogue” employee who is not correlated with a “directing mind and will” the corporate “failure to prevent” is a suitable means to attribute organisational liability and the offence is well-framed to express the nature of the corporate wrongdoing. However, an altogether different basis of liability is needed to establish *corporate* fault of a quality that is not reducible to the criminality of particular individuals. This section evaluates potential alternative approaches to reform.

### **A “failure to comply with prescribed standards” model?**

The Corporate Manslaughter and Corporate Homicide Act 2007 constructed a bespoke model of liability, confined to manslaughter, which essentially turns on gross negligence but, unlike

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<sup>258</sup> *R. v Cogan; R. v Leak* [1976] Q.B. 217.

<sup>259</sup> *Moore v Bresler Ltd.* [1944] 2 All E.R. 515.

the common law doctrine, serves to aggregate the fault of senior managers.<sup>260</sup> Otherwise, alternative proposals for a generic basis of corporate criminal liability tend to focus on the attribution of fault by reference to the corporate conduct falling below some objective standard or by some failure to comply with a particular duty.<sup>261</sup> The “failure to comply with prescribed standards” model avoids the tricky issue of *mens rea* altogether by constructing liability on a negligence-type basis. Negligence is not a mental state but necessitates an objective assessment of behaviour measured by reference to standards of reasonableness. Arguably, this model constitutes the essence of the regulatory approaches which have been discussed above and, as an approach to corporate misbehaviour, negligence attracts little criticism. However, as a mark of criminality, negligence arguably fails in its expressive function, conveying far less opprobrium than the notions traditionally invoked with requirements of intentionality, subjective recklessness and dishonesty.<sup>262</sup> In this respect, the conduct is typically considered more akin to regulatory non-compliance than true criminality and, constructed in this way, lacks the deterrent bite of the threat of conviction for “real” crime. It is of note that individuals are not generally subject to criminal sanction on the basis of negligence<sup>263</sup> and a more blameworthy state of mind is required before the criminal law is invoked. As a matter of principle, offence definitions should capture the true nature of the organisational criminality and do so by reference to a culpable standard comparable to individual liability.<sup>264</sup> Furthermore, in contrast to the more defining requirements of criminal intent and the traditional “act doctrine”, negligence is controversial as a basis of criminal liability in that it is more readily associated with a failure to act or to take sufficient care when doing so.

In the context of corporate fraud, neither the “failure to comply” with prescribed standards nor the negligence-type models are satisfactory. The suggestion that a company can commit fraud through negligence or omission fails to express the true nature of fraud which typically involves dishonesty and the making of some false or misleading statement with intent. As both models avoid corporate prosecution for the substantive offence, the organisation would not have a conviction for fraud but for wrongdoing of an altogether different nature; neither approach truly acknowledging that companies themselves can behave fraudulently through the emergence of a criminogenic culture. Furthermore, the fact that a statement may be both true and at the same time misleading undermines any approach which does not encompass the

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<sup>260</sup> Corporate Manslaughter and Corporate Homicide Act 2007, s.1.

<sup>261</sup> See for example, B. Fisse and J. Braithwaite, *Corporations: Crime and Accountability* (Cambridge University Press, 1993) 29; G.R. Sullivan, “The Attribution of Culpability to Limited Companies” (1996) 55(3) *Cambridge Law Journal* 515; E. Lederman, “Models for Imposing Corporate Criminal Liability: From Adaptation and Imitation toward Aggregation and The Search for Self-Identity” [2001] *Buffalo Criminal Law Review* 64; J. Gobert, ‘Corporate Criminality: New Crimes for the Times’, (1994) *Criminal Law Review* 722; <sup>261</sup> J. Gobert and M. Punch, *Rethinking Corporate Crime* (Butterworths, 2003).

<sup>262</sup> A. Cronin, ‘Reforming Corporate Fraud Regulation in the UK: A Model of Manifest Liability’ op. cit.

<sup>263</sup> There are a couple of notable exceptions, for example the Domestic Violence, Crime and Victims Acts 2004 and 2012 causing or allowing a child to die or suffer serious injury by an unlawful act and the common law public nuisance matter.

<sup>264</sup> A. Cronin, “Reforming Corporate Fraud Regulation in the UK: A Model of Manifest Liability”, PhD thesis, Bournemouth University (Taylor Francis, 2017, forthcoming) *sub nom* “Corporate Criminality and Liability for Fraud”.

notion of dishonesty.<sup>265</sup> It is this essential element that leads back to the seemingly intractable conundrum, how to attribute *mens rea* to modern, structurally diverse corporations.

### **An evidential presumption as to corporate liability?**

Intractable as this challenge may be, insurmountable it is not. Indeed, the obstacles posed by the need to attribute corporate *mens rea*, namely dishonesty and fraudulent intention, can be overcome with a simple Criminal Practice Direction in relation to the trial process for offending of this nature. This would amount to no more than a clear restatement of orthodox and well-established evidential presumptions within the criminal law. Indeed, the presumption of intention was placed on a statutory footing by Criminal Justice Act 1967, s. 8 acknowledging that a person may be presumed to have intended or foreseen the natural and probable consequence of his act, and that the presumption may be refuted by other evidence raising contrary inferences.<sup>266</sup> This provision clarified the position after the misinterpretation in *DPP v. Smith* [1961],<sup>267</sup> the evidential presumption being generally applicable in criminal law despite the language of “natural and probable consequences” being the subject of a judicial onslaught in the narrow context of the murder offence.<sup>268</sup> Accordingly, the requisite intention in relation to fraud, i.e. the intention to make a gain for oneself or another or to cause loss or expose another to a risk of loss, can be established in this way. As a matter of statutory interpretation, this clearly applies in a corporate context because Sch. 1, Interpretation Act 1978 states that where an act refers to a “person” this includes a body of persons incorporate or unincorporated. The orthodox presumptive approach has the advantage of enabling a finding of corporate intention in the absence of a metaphysical “mind” while leaving the traditional *actus reus* / *mens rea* construct of criminality undisturbed. A corporate intent for fraud would be readily ascertained by the inference that the organisation intended to make a gain as a result of, for example, its sales activity, since this is the natural and probable result of such activity.

The presumptive approach to dishonesty is also well-established, the use of false statements being *prima facie* evidence of an intention to defraud which is, itself, synonymous with dishonesty.<sup>269</sup> It is suggested that the notion of dishonesty operates at 2 levels and, taking

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<sup>265</sup> S.F. Copp and A. Cronin, “The Failure of Criminal Law to Control the use of Off Balance Sheet Finance During the Banking Crisis” (2015) 36(4) *Company Lawyer* 99.

<sup>266</sup> The status and effect of the presumption of intention is explored fully in A. Cronin, “Reforming Corporate Fraud Regulation in the UK: A Model of Manifest Liability”, PhD thesis, Bournemouth University (Taylor Francis, 2017, forthcoming) *sub nom* “*Corporate Criminality and Liability for Fraud*”.

<sup>267</sup> *DPP v Smith* [1961] A.C. 290 (HL).

<sup>268</sup> A. Cronin, “Reforming Corporate Fraud Regulation in the UK: A Model of Manifest Liability”, PhD thesis, Bournemouth University (Taylor Francis, 2017, forthcoming) *sub nom* “*Corporate Criminality and Liability for Fraud*”.

<sup>269</sup> For example, in the context of obtaining by false pretences, Larceny Act 1916, s.32(1) and the commentary in R.E. Ross and M.J.H. Turner, *Archbold’s Criminal Pleading: Evidence and Practice* (30<sup>th</sup> ed., Sweet & Maxwell 1938) 724; *R. v Hopley* (1916) 11 Cr. App. R. 248 (CCA) and in the context of fraudulent trading see D. French, S. Mayson & C. Ryan, *Company Law* (Oxford: Oxford University Press, 2016-2017) pp. 700-702). Further, in *R. v*

fraud by false representation by way of illustration,<sup>270</sup> proof of a false representation is itself proof of a dishonest means while evidence of an intention to gain or cause a loss equates to proof of a dishonest end. In effect, the issue of dishonesty is presumed from the conduct such that the evidential burden is effectively shifted to the defendant where honesty is claimed, for example through a “claim of right” defence.<sup>271</sup> On this construction of liability, a corporate defendant would be afforded the opportunity, as are individual defendants, to assert that the activity in which it was involved was an honest one. Indeed, this approach conforms to the common law test of dishonesty as expressed in *R v Ghosh* [1982] which contains both an objective and subjective limb.<sup>272</sup> The presumptive mechanisms of fault attribution have been supported elsewhere with the recognition that the orthodox evidential presumptions are entirely consistent with the subjective individualist account of criminal doctrine as supported by recent neuro-scientific findings.<sup>273</sup> Accordingly, culpability for financial crime can be attributed directly to a corporation without disturbing existing doctrine, where this more readily reflects the nature of the wrongdoing and wrongdoer. In this respect, the Canadian courts have gone further still in that the subjective prong of the *Ghosh*<sup>274</sup> test of dishonesty is not applied<sup>275</sup> and it is considered objectively as a part of the *actus reus*, playing only a minimum part in *mens rea* as “fraudulently”.<sup>276</sup> The implication of the explicit acknowledgement of the presumptive approach is that a mainstream prosecution for fraud could be brought<sup>277</sup> against a corporation where the conduct appears fraudulent, i.e. where there is a false or misleading statement made with a view to making a gain or cause a loss to another and the ordinary decent person would consider it dishonest. Again, a Criminal Practice Direction, or guidance, could be used to clarify the application of the evidential presumptions and how a defence might be raised by the defendant, corporate or otherwise, in rebuttal. Where the charge is one of *corporate* fraud, premised on dishonesty as the determinative characteristic, the corporation can, like any individual, defend the allegation on the basis that what it did was not dishonest.

The authors have concluded that the evidential presumption is the most effective way to address corporate liability. Supplementing the legal and procedural developments necessary to address the problem of criminogenic organisations and corporate fraud, the consequential resource implications could be met with a fundamental, and likely cost-effective, shift in

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Wright [1960] *Criminal Law Review* 366 and J.W.C. Turner, *Kenny’s Outlines of Criminal Law* (Cambridge University Press, 1966) p.365 it was affirmed that intent to defraud is synonymous with dishonesty.

<sup>270</sup> Fraud Act 2006, s.1(2)(a) and s.2.

<sup>271</sup> D.J. Baker, *Glanville Williams Textbook of Criminal Law* (Sweet & Maxwell, 2015) p. 1453. See too A. Cronin, “Reforming Corporate Fraud Regulation in the UK: A Model of Manifest Liability”, PhD thesis, Bournemouth University (Taylor Francis, 2017, forthcoming) *sub nom* “*Corporate Criminality and Liability for Fraud*”.

<sup>272</sup> *R. v. Ghosh* [1982] Q.B. 1053 (CCA). The test set out requires that the conduct was dishonest by the standards of ordinary decent people and that the defendant realised it was dishonest by those standards.

<sup>273</sup> A. Cronin, “Reforming Corporate Fraud Regulation in the UK: A Model of Manifest Liability”, PhD thesis, Bournemouth University (Taylor Francis, 2017, forthcoming) *sub nom* “*Corporate Criminality and Liability for Fraud*”.

<sup>274</sup> *R. v Ghosh* [1982] Q.B. 1053 (CCA).

<sup>275</sup> *R. v Theroux* [1993] 2 S.C.R. 5.

<sup>276</sup> *R. v Skalbani* [1977] 3 S.C.R. 995

<sup>277</sup> Subject to the usual evidential and public interest tests.

funding from regulation and regulatory compliance to bodies concerned with the investigation and prosecution of serious crime.

## CONCLUSIONS

The international and national scale of the problems of money-laundering, fraud, bribery and tax evasion pose serious challenges to legal systems. There is some evidence to suggest that the enforcement of the Bribery Act 2010 “failure to prevent” model of corporate criminality has been more effective than the traditional model of liability based around the individualist approach that requires proof of *mens rea* and its application to the corporation via the identification principle. It is unsurprising, therefore, that policymakers are turning to this new model as a potential panacea, despite the appearance of uncertainty resulting from policy changes. Nonetheless, the evidence as to corporate awareness of the new legislation is mixed and to date there has been just one conviction, and three DPA’s, for this offence. History, however, demonstrates the need for caution. The bribery legislation was enacted because the UK was in danger of being seen as soft internationally in its response compared with other jurisdictions such as the US. Insofar as there are historical precedents for the use of a “failure to prevent” approach, they were generally unsuccessful and eventually repealed. Perhaps the closest example can be found in the Money-Laundering Regulations 2007 but on closer examination it is little more than a regulatory offence to ensure detailed administrative compliance. The true novelty of the Bribery Act 2010 “failure to prevent” offence was the creation of a serious criminal offence that blurs the line with regulatory offences by allowing a defence based on regulatory-type compliance. In addition, the Bribery Act is enforced by the SFO and CPS rather than the FCA and PRA which suggests a much tougher enforcement stance, even though the fines issued by the FCA are growing in size and consequent ability to deter. In contrast, many issues relating to potentially fraudulent conduct are treated in the regulatory system as little more than matters of consumer protection, an insufficiently robust response. This, it is submitted is wrong, fraud and bribery should both be stigmatized and subjected to the full weight of the law alike. Whilst there are benefits to both the common law “identification” principle and an “economic crime” of “failure to prevent” fraud, combined with due diligence defence, these will not work in all cases, namely where the fraud involves corporate rather than individual dishonesty. In such situations, a new model of criminalising the corporation is needed.

The board of directors of a company subject to the UK Corporate Governance Code 2016 is expected to set a company’s strategic aims, its values and standards; they are further expected to provide entrepreneurial leadership within a framework of prudent and effective controls which enable risk to be assessed and managed (Section A.1 Supporting Principles). No board of directors should, in effect, be able to deny knowledge of a widespread dishonest culture in their company, especially where the directors may benefit from such a culture by way of their remuneration packages. Where there is such a culture the company itself, in addition to individuals, must be stigmatized. The authors submit that the most straightforward way of achieving such stigmatization is by a simple Criminal Practice Direction in relation to offending of this nature restating orthodox and well-established evidential presumptions in

the criminal law. Such stigmatization will send a powerful signal to markets who can respond appropriately in how they value the company and, through the takeover mechanism, lead to changes in the board of directors beyond the reach of the criminal law. In this way, it is hoped that through the complementary roles of a strong criminal law which is necessary to protect investors' property rights and the operation of efficient market forces, criminogenic corporate leadership will be driven out of the market and criminal corporate culture replaced by socially desirable behaviour.